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IN THE UNITED STATES PATENT AND TRADEMARK OFFICE
BEFORE THE TRADEMARK TRIAL AND APPEAL BOARD

Proceeding	91161817
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IN THE UNITED STATES PATENT AND TRADEMARK OFFICE
BEFORE THE TRADEMARK TRIAL AND APPEAL BOARD

NEXTEL COMMUNICATIONS, INC., Opposer,	)	Opp. No.: 91/161,817
v.	)	App. No.: 78/235,618
MOTOROLA, INC., Applicant.	)	Pot. Mark: SENSORY MARK (911 Hz tone)

OPPOSER'S REPLY
TO APPLICANT'S BRIEF

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OPPOSER'S REPLY
TO APPLICANT'S BRIEF

I. INTRODUCTION

In its Brief, Applicant forthrightly admits that the "first purpose" of the 911 Hz tone is "a non-trademark purpose." App. Br. at 4. With this critical admission, much of the remainder of Applicant's argument becomes irrelevant or simply wrong.

In essence, Motorola is attempting to transmogrify a commonplace operational feature of its product into a mark, without ever having treated it as a mark. Permitting it to register this operational alert tone would harm Nextel's interests in protecting its own Nextel Chirp sound mark.

The facts show that Motorola first designed and built the electronics that produced the 911 Hz tone, and incorporated it as one of the many operational alert signals emitted by its two-way radios, some 24 years ago. *See* App. Br. at 18. Notwithstanding that the trunked two-way radios Motorola sold beginning in 1983 all emitted that same signal, Motorola asserts that its date of first "use" of the tone in commerce was not until May 1991, which it explains is the date Motorola made "technical alterations to the apparatus that generates the sound," albeit "imperceptible to the human ear." *Id.*, at n.7. It would be another twelve years after that supposed "use" before Motorola decided to file a registration application for the sound and, significantly, a second application for registration of the chirp sound that Nextel claims as its own mark. *See* Ex. A, Nextel Chirp Application File Wrapper.[1]

[1] Citations herein to Exhibits A through P refer to the exhibits cited in Opposer's Trial Brief, filed March 15, 2007. Opposer's Trial Brief is referred to herein as "Opp. Br." and Applicant's Trial Brief, filed April 16, 2007, is referred to herein as "App. Br."

During this whole 24-year period, Motorola consistently demonstrated the sound as, and trained its users to recognize it as, an alert signal meaning that a channel was open and the user could now talk over the radio. During this whole 24-year period, Motorola never engaged in "listen for" advertising mentioning the sound in any way, or otherwise suggested any trademark significance of the alert signal.

After Nextel filed its opposition in this proceeding, Motorola commissioned a survey whose very design implicitly acknowledged this non-trademark purpose of the sound. It had two steps. First, against the backdrop that the sound had always been demonstrated as signifying an operational "event" – the radio's acquisition of an open channel – the survey asked a question designed to elicit the sound's association not with a source but with an "event." *See* Ex. N, Rappeport Trial Tr., at Ex. 2 (at MOT 004677). Then, against the backdrop that the radios were all prominently emblazoned with the name MOTOROLA and the Motorola trademarks, the survey again avoided asking about any association of the sound with a source, and instead asked for an association of the radios with a source. *See id.* But despite the fact that this two-step design was perhaps the most likely to elicit mentions of Motorola notwithstanding the fact that the sound had only been used in its non-trademark role, the ultimate results of the survey did not even produce a significant number of Motorola mentions.

The reality of this case is that Motorola is seeking registration of a sound that has never been used as a mark and does not function as a mark. Registration should be denied.

II. ARGUMENT

A. Motorola's Central Legal Arguments Are Irrelevant.

Motorola's brief mischaracterizes Nextel's key arguments, apparently for the purpose of seeking more plausible ways to refute them. Motorola's arguments on these issues are simply irrelevant.

Nextel has not argued that sounds can never be registered as trademarks, *compare* App. Br. at 15-16, but instead has demonstrated that this particular sound cannot be registered because it has not been used as a mark and does not function as a mark. Opp. Br. at 28-33.

Similarly, Nextel has not argued that dual purpose marks cannot be registered, *compare* App. Br. at 18, but instead has demonstrated that this particular alert signal is not a dual purpose mark, because it does not function as a mark, and serves only a single, non-trademark purpose.[2] *See* Opp. Br. at 28-33.

Nextel has not argued that the alert signal is "functional" under Section 2(e)(5) of the Act, *compare* App. Br. at 20-22, but instead has demonstrated that this alert signal cannot be registered because it serves only a non-trademark "function." Opp. Br. at 5, 28-33.

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[2] Each "dual purpose" case cited by Motorola makes clear that proof of use as a source-identifying trademark is a prerequisite to registration. *In re Paramount Pictures*, 217 U.S.P.Q. 292, 293 (TTAB 1983) ("it is clear that [STAR TREK] performs a trademark function" when used on towels, sheets, etc., as when used on other goods for which registrations had issued); *In re Moody's Investors Serv. Inc.*, 13 U.S.P.Q.2d 2043, 2048-49 (TTAB 1989) (while financial rating symbol could serve dual purpose, evidence of the way Applicant used it established that it would be perceived by the public as referring to the rating itself, and not its source, and registration was refused); *In re Jockey Int'l, Inc.*, 192 U.S.P.Q.2d 579, 582-83 (TTAB 1976) (feature of product design found registrable, but only upon proof of intentional adoption as a trademark, extensive use on packaging and in advertising in an express "Always Look For This Mark" context designed to identify the feature as a "badge of origin," and survey evidence indicating purchasers distinguished the goods by the design feature).

And Nextel has not argued that sound marks cannot be inherently distinctive, *compare* App. Br. at 23-24, but instead has demonstrated that that this particular electronic alert signal for two-way radios is not inherently distinctive. Opp. Br. at 33-36.

B. Motorola Provides No Evidence That the 911 Hz tone Has Been Used as, or Functions as, a Mark.

Motorola's brief is peppered with assertions that the 911 Hz tone serves as, or that Motorola has used it as, a trademark, citing only the testimony of its employee David Klein. *See, e.g.,* App. Br. at 17, 18, 21, 25, 26, 32, 33, 34. But there is not a single shred of documentary evidence of any such use. Motorola has not presented a single audio tape or videotape of any presentation of the tone other than in its function as an operational alert signal. Motorola has not presented any written material referring to the tone other than in its function as an operational alert signal. And a careful reading of Mr. Klein's testimony reveals that he provided no valid evidence at all that the tone was ever used as a mark or functioned as a mark.

Mr. Klein's cited testimony generally consists of (1) unsubstantiated assertions that sales people made certain references to the sound, and that there was a "linkage" between the sound and a supposed message about Motorola products, or (2) unsubstantiated assertions that customers understood the sound as source-identifying. None of these assertions provides valid evidence in support of registration of the tone.

Regarding the first set of assertions, Mr. Klein did not present a single example of any actual direct statement made by Motorola in sales presentations or at trade shows that constituted trademark use of the alert tone.[3] Instead, he repeatedly described the live demonstration of the

[3] In fact, in his discovery deposition as Motorola's 30(b)(6) witness, Mr. Klein, when asked whether he was aware of any instance in which Motorola featured the 911 Hz tone other than in connection with operation of the function that it signifies, stated "I'm not aware of any other – any other presentation of that tone." Ex. I, Klein Dep., at 123:20-21; *see also* Ex. O, Klein Trial Tr., at 101:10-16.

tone, functioning as an operational alert signal indicating that the channel was open to speak, and then asserted without support that there was a "linkage" between this message and an implicit message about the nature of Motorola's products. Ex. O, Klein Trial Tr., at 104:2-4 ("in my personal experience I would say that that is indicative of a linkage"). He described that implicit message variously as "reliable communications, always-there communications, instant communications," *Id.* at 18:6-7; "you're having a device that is giving you immediate communication capability," *Id.* at 18:9-10; "products that met this high level of operational benchmark," *Id.* at 19:15-16; "they're always going to be able to get through," *Id.* at 20:13; "everything is working right," *Id.* at 20:17; "you always have the opportunity for communication," *Id.* at 28:15-16; "always there," *Id.* at 28:17; "guaranteed communications" *Id.* at 44:6; "reliable communications," *Id.* at 78:11-12; "immediacy of response," *Id.* at 101:4; and "a two-way radio being robust, reliable, dependable," *Id.* at 101:6-7.

The notable fact about all these asserted "trademark" messages is that they are identical to the <u>non</u>-trademark message of the 911 Hz tone. It's as if the applicant in the *Organon* case had provided evidence that whenever it provided samples of its medication for people to try, it said "when you taste our orange-flavored medications you know they will have an orange flavor."

Indeed, in the sole example in which Mr. Klein purported to provide an actual statement he made in a trade show, he makes this same point all too clearly:

> "I have done the trade shows where I've placed the radio in the users' hands and said press it, hear the tone, that means you're on the system. That means you're – this is working. No matter what happens[,] when you hear that tone, your Motorola radio is working and you're able to get through."

Id. at 78:20 through 79:1. He conceded, however, as he must, that when the user is not able to get through, he hears a "talk-prohibit" tone when he pushes that same button, and that it is important for users to recognize the meaning of that different tone. *Id.* at 75:22 through 76:12. At trade shows, sales presentations, and in training, the other alert tones are also made audible, whenever the event they are intended to signal occurs. *Id.* at 80:17 through 81:4.

Motorola's unsubstantiated assertions about this so-called "experiential advertising" are insufficient to establish that it ever used the alert tone as a trademark. *See, e.g., In re Ennco Display Sys., Inc.,* 56 U.S.P.Q.2d 1279, 1286 (TTAB 2000) (applicant failed to present "any convincing evidence of advertising or promotional efforts that focus upon the trademark significance" of the product configurations sought to be registered).

Regarding the second set of unsubstantiated allegations, Motorola also asserts, based on Mr. Klein's testimony, that users understand or perceive the tone as indicating not just that a channel is open but that Motorola is the source of the two-way radios. *See* App. Br. at 32, 34. Besides the fact that these hearsay and speculative assertions are uncorroborated by any direct evidence, Mr. Klein repeatedly explains that the association with the source comes not from the tone itself but from the prominent brand markings all over the radios. Moreover, Motorola's own survey, to the extent Motorola argues that it provides any information about consumer associations with the 911 Hz tone, must be read to prove that there is no such association with Motorola.

As an initial matter, Mr. Klein's testimony as to the effect of any so-called "experiential advertising" on the minds of consumers is wholly unsupported by corroborating evidence and entitled to little, if any, weight. *See In re David Crystal, Inc.*, 132 U.S.P.Q. 1, 2, n.2 (CCPA 1961) (affidavit of president of Applicant company regarding acquired distinctiveness from an interested party given "little weight."); *McCarthy on Trademarks and Unfair Competition* at

15:40 (2006) ("Conclusory testimony by employees as to the probable mental reactions of buyers is often merely self-serving evidence given to satisfy the employer.").

But as Mr. Klein makes clear, any recognition of the two-way radios as Motorola products must come from the prominent use of Motorola's house marks, not from hearing the operational alert signal when the channel is open. As he explained, "there is this branded radio that has Motorola written all over it that is presenting this tone," Ex. O, Klein Trial Tr., at 17:2-3; "this tone is depicted in multiple ways in association with the branding, the Motorola name and insignia," *id.* at 17:15-17; "beyond the training they have had general experience in knowing that when they hear that tone and they see the radio, as you put in their hand emblazoned with Motorola, they are going to understand what that tone means," *id.* at 76:24 through 77:4. In fact, he explained the use of the Motorola marks on the radios as follows:

> Motorola goes through a large effort to ensure that the Motorola branding is always visible from almost every single angle that you can look at our products. Customers have actually mentioned that perhaps we have gone overboard with the labelings and the visibility of the Motorola bat wing icon or the Motorola label. So it's always visible. Whenever you're using this product, when you hear that tone, you are seeing Motorola.

Id. at 18:23 through 19:8. Such reliance on the Motorola house marks for source indication of the products does not establish that the alert signals they emitted served independently as source identifiers.

In any event, Motorola's own survey demonstrates, if anything, that users do not associate the tone with Motorola. In response to the survey's first question, not a single respondent upon hearing the 911 Hz tone identified Motorola only. Even considering the responses to the second question, which redirected the focus to the Motorola-emblazoned radios rather than the alert tone itself, only 11 percent of the respondents named Motorola only. *See* Ex. N, Rappeport Trial Tr., at 34:3-4 and at Ex. 2 (at MOT 004686).

There is thus no evidence in the record that the 911 Hz tone was ever used by Motorola as a trademark, and no evidence that it functions as a trademark.[4]

Motorola argues that the cases cited by Nextel regarding the standard for finding that a designation serves a trademark function are "inapposite," essentially on the ground that each of these cases involved some fact or situation, however immaterial to the ultimate holding, that is not presented here. App. Br. at 22-24. But the cases apply fundamental statutory principles that are applicable here. The fact that the exact case has not previously been decided does not mean that the Board cannot be guided by those past precedents in deciding this case.

Motorola says in particular that it is "curious" that Nextel would rely on the *Textron* and *Procter & Gamble* cases. App. Br. at 25. But *Textron* holds that while multiple marks may be registered, the test for each is whether it makes a distinct commercial impression. *Textron Inc., v. Cardinal Eng'g Corp.*, 164 U.S.P.Q. 397, 399 (TTAB 1969). There, the Board found a constant pattern of effort by Textron to use the mark in a manner separate and distinct from its house mark, and held that it thus "creates a distinctive and separate impression . . . and serves, in and of itself, as a trademark to identify and distinguish Textron's chain saws in commerce." 164 U.S.P.Q. at 400. Here, the evidence is exactly the opposite. Motorola attempted to use its house mark to have its customers recognize the operational meaning of the 911 Hz tone. *See* Ex. O, Klein Trial Tr., at 103:16 through 104:4.

C. Even if the Tone Had Been Used as a Mark, It is Not Distinctive

Motorola argues that the 911 Hz tone is registrable because it is either inherently distinctive or has acquired distinctiveness. App. Br. at 26-45. But without even reaching the

[4] Indeed, Mr. Klein admitted that he was unaware of any evidence that Motorola had expressly focused customers or users on the alert tone as a trademark. *See* testimony cited at Opp. Br. at 10-11.

question of whether a sound that may be recognizable to consumers can be registered at all when it has not been used as and does not function as a mark,[5] Motorola has failed to demonstrate that the 911 Hz tone is distinctive.

1. The Sound is Not Inherently Distinctive.

Motorola asserts, without support, that the 911 Hz tone is inherently distinctive because it is "unique, different, and distinctive." App. Br. at 26. But "inherent distinctiveness" in this context means that a sound has the ability to distinguish goods from those manufactured by others and to indicate source, not just that it can be distinguished from other sounds. *See In re Soccer Sport Supply Co., Inc.*, 507 F.2d 1400, 1402, 184 U.S.P.Q. 345, 347 (CCPA 1975) (design may be inherently distinctive if it is "arbitrary and distinctive and if its principal function is to identify and distinguish the source of the goods") (emphasis added); *In re Raytheon Co.*, 202 U.S.P.Q. 317, 318 (TTAB 1979) (design may be inherently distinctive if it can itself "create a commercial impression as an indication of origin").

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[5] If a designation does not function as, and has not been used as, a source-indicating trademark, it cannot be registered notwithstanding evidence of distinctiveness. *See* TMEP 1212.02(i); *see also, e.g., In re Mancino*, 219 U.S.P.Q. 1047, 1048 (TTAB 1983) ("Since the refusal . . . was based on applicant's failure to demonstrate technical service mark use, the claim of distinctiveness under Section 2(f) was of no relevance"); *In re Wakefern Food Corp.*, 222 U.S.P.Q. 76, 78-79 (TTAB 1984) (finding that a phrase "would not be perceived by the public" as a source-identifying mark and was thus unregistrable, and that evidence of distinctiveness was therefore irrelevant, even though that evidence supported a finding that the phrase was associated with the applicant, and was not merely descriptive). In *In re Owens-Corning Fiberglas Corp.*, 221 U.S.P.Q. 1195 (TTAB 1984), where the Board determined that the applicant's pink color for fiberglass insulation did not function as a trademark, it had considered evidence submitted by the applicant under Section 2(f) as also relevant to the question of whether the color functioned as a mark. *Id.* at 1198 & n.3. On review of that same evidence, the Federal Circuit reversed the Board's finding that the color did not function as a trademark, and permitted registration under Section 2(f). *In re Owens-Corning Fiberglas Corp.*, 227 U.S.P.Q. 417, 425 (Fed. Cir. 1985). Although the Board's approach was not disputed by the applicant on appeal, the court treated the question before it as whether the color was registrable under Section 2(f). *Id.* at 422. Unlike the case here, however, the evidence established that (1) the applicant's use of the color "perform[ed] no non-trademark function," (2) applicant had engaged in extensive advertising and promotion that specifically emphasized the color, and (3) 50% of respondents in a valid consumer survey identified the applicant as the manufacturer of pink insulation. *Id.* at 421, 423-24.

Where, as here, the "first purpose" of a designation is a non-trademark purpose, *see* App. Br. at 4, the analysis for finding the designation inherently distinctive must take that fact into account. In the context of trade dress and "dual use" ornamentation cases, for example, the Board and the courts have refused to find a design inherently distinctive, even if it is indisputably unique in terms of not being identical to any design used by others, if it represents a "'mere refinement of a commonly-adopted and well-known form of ornamentation for a particular class of goods viewed by the public as a dress or ornamentation for the goods.'" *In re Hudson News Co.*, 39 U.S.P.Q.2d 1915, 1922 (TTAB 1996) (*quoting Seabrook Foods, Inc. v. Bar-Well Foods, Ltd.*, 196 U.S.P.Q. 289, 291 (CCPA 1977)); *In re J. Kinderman & Sons, Inc.,* 46 U.S.P.Q.2d 1253, 1255 (TTAB 1998); *In re The General Tire & Rubber Co.*, 160 U.S.P.Q. 415, 416-17 (CCPA 1969) (typical purchaser would view alleged mark as just a refinement of a widely used ornamentation "concept" rather than as a trademark).

Where the designation is not mere ornamentation, but is, as here, an operational feature of the product, the ability of the designation to serve as a source indicator is even more attenuated. *See In re N.V. Organon*, 79 U.S.P.Q. 2d 1639, 1649-51 (TTAB 2006). The pertinent question is that of consumer perception. *See Anchor Hocking Glass Corp. v. Corning Glass Works*, 162 U.S.P.Q. 288, 292 (TTAB 1969). Because of its primary non-trademark purpose, the typical purchaser or user would first view the operational feature as just that, and not as a designation that serves as an inherently distinctive source identifier. Nextel does not argue that a non-traditional mark may never be found to be inherently distinctive. But under the consistently applied analysis of Board and court decisions, the evidence in this case substantiates the conclusion that the 911 Hz alert signal is not inherently distinctive.

Applicant argues essentially that, in order for the Board to find that the 911 Hz tone is not inherently distinctive, it must have evidence that the tone is actually used in other two-way radios. App. Br. at 26-27. But the case law requires only that the purported mark be shown to be a variant of a common feature or concept incorporated in other products of the same class. *See, e.g., Organon*, 79 U.S.P.Q. at 1643-44; *CITC Indus., Inc. v. Levi Strauss & Co*, 216 U.S.P.Q. 512, 516 (TTAB 1982); *Anchor Hocking*, 162 U.S.P.Q. at 291. Here, as two-way radio expert Rik Rasmussen testified, all trunked two-way radios incorporate a short electronic "little beep or chirp or whatever" that has the purpose of signaling the availability of a channel, along with numerous other short electronic tones signaling other operational functions of the radio. [6] Ex. L, Rasmussen at 24:8-20, 29:10 through 30:19. Motorola's witness Mr. Klein testified that he assumed that all two-way radios must emit a similar alert signal. Ex. I, Klein Dep., at 92:14-17.

Motorola relies heavily on Mr. Rasmussen's testimony that he could tell the difference between alert tones from various manufacturers' radios. App. Br. at 27. But whether Mr. Rasmussen, Mr. Klein, or anyone else could distinguish one alert tone from another (as indeed is the design objective of the various alert signals in a radio) is simply irrelevant to the question at hand. The question is not whether the 911 Hz tone differs from tones made by other two-way radios, but rather whether the 911 Hz tone is inherently distinctive. *In re Glaxo Group Ltd.*, 53 U.S.P.Q.2d 1920 (TTAB 2000) ("While it may be true that applicant's particular color scheme may be said to be 'unique' because no other company uses applicant's precise color scheme, this does not necessarily mean that applicant's asserted mark is inherently distinctive."); *In re E S Robbins Corp.*, 30 U.S.P.Q.2d 1540, 1542 (TTAB 1992) (that a design might be said to be

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[6] Motorola's assertion that there are other means to signify operational status, App. Br. at 28, also misses the point. Mr. Rasmussen's uncontroverted testimony evidences not what manufacturers could do, but what they actually do – use short, electronic tones to signal operational status.

unique in the sense that it was a "one and only," perceptibly different from all competitors' designs, is insufficient to establish inherent distinctiveness for registration purposes).

In *CITC*, the Board denied registration for a pattern of geometric shapes on the sole of a shoe, because even though the shapes were different from those used by others, the use of various repeated shapes on shoe soles was a common practice in the trade. *See* 216 U.S.P.Q. at 516. But it noted in particular that the applicant also prominently featured its house mark on the soles of the shoes. *Id.* at 516-517. In that circumstance, the Board concluded that the sole design would not be perceived as a mark. *Id.* at 517. Similarly here, the fact that Motorola's house mark is so prominently emblazoned on the two-way radios would also diminish the possibility that the 911 Hz alert tone would be perceived as a mark, unless Motorola had taken additional steps to have the tone create a separate and distinct commercial impression as a source identifier. In fact, however, Motorola has done the opposite.

Interestingly, Motorola's brief does not even address the fact that over 30 percent of the survey respondents to Motorola's own survey, who were users or potential purchasers of Motorola's products, thought the tone sounded like it came from various other devices they encountered in everyday life, such as a heart monitor, an electronic game, a smoke detector, an answering machine, a computer, a cell phone, a scanner or an electronic measuring device. *See* evidence cited at Opp. Br. at 18-19. These responses show that the nature of the 911 Hz tone is such that for a substantial percentage of users or potential users of two-way radios, it resembles or imitates commonplace sounds to which they have been exposed in different circumstances.

Again, Nextel does not argue that no sound may ever be found inherently distinctive. *Compare* Opp. Br. at 34 *with* App. Br. at 28. As the Board explained in the *GE* case, however, a sound that is commonplace or has been heard under other circumstances may not be deemed to be inherently distinctive for trademark purposes. *In re General Electric Broad. Co., Inc.*, 199 U.S.P.Q. 560, 563 (TTAB 1978). Here, the expert testimony and the actual evidence of listeners' perceptions establish that the 911 Hz alert tone is not inherently distinctive.

2. The Sound Has Not Acquired Distinctiveness.

Because the 911 Hz tone is not inherently distinctive, Motorola has the burden of proving by at least a preponderance of the evidence that the mark has acquired distinctiveness. *American Flange & Mfg. Co., Inc. v. Rieke Corporation*, 80 U.S.P.Q.2d 1397, 1411 (TTAB 2006).

a. Motorola's Circumstantial Evidence of Acquired Distinctiveness is Insufficient

First, Motorola's circumstantial evidence falls far short of meeting its burden. Because Motorola did not use the tone in a source-indicating capacity, Motorola's asserted evidence of trade show expenditures, sales, and length of use of the alert signal provide no support for a finding of acquired distinctiveness. *See In re Redken Labs., Inc.*, 170 U.S.P.Q. 526, 529 (TTAB 1971); *In re E.I. Kane, Inc.*, 221 U.S.P.Q. 1203, 1206 (TTAB 1984). Moreover, Motorola has provided no evidence regarding any portion of Motorola's annual trade show budget that is supposedly attributable to the 911 Hz tone. *See* Ex. O, Klein Trial Tr. at 94:2-21. Motorola's assertions that it has expended hundreds of thousands of dollars per year on trade shows, App. Br. at 33, are thus not probative of acquired distinctiveness. *See Duraco Prods. Inc. v. Joy Plastic Enter. Ltd.,* 32 U.S.P.Q.2d 1724, 1741 (3d Cir. 1994); *E.I. Kane*, 221 U.S.P.Q. at 1206; *In re Semel*, 189 U.S.P.Q. 285, 287 (TTAB 1975). For the same reason, evidence of the playing of the tone in training and demonstrations, presented as an operational alert signal, *see* Ex. O, Klein Trial Tr., at 101:10-16; Ex. I, Klein Dep., at 104:23 through 105:3, cannot constitute circumstantial evidence of acquired distinctiveness.

Similarly, in the absence of any evidence that Motorola ever attempted to emphasize the 911 Hz tone as a trademark, the fact that the same alert signal may have been incorporated in two-way radios for a long period of time is unavailing. *See, e.g. In re Packaging Specialists, Inc.*, 221 U.S.P.Q. 917, 920 (TTAB 1984); *Yamaha Intl. Corp. v. Hoshino Gakki Co. Ltd.*, 6 U.S.P.Q.2d 1001, 1004 (Fed. Cir. 1988). The volume of Motorola's sales of two-way radios that incorporate the alert signal are likewise irrelevant. *See, e.g. In re Bongrain Int'l (American) Corp.,* 13 U.S.P.Q.2d 1727, 1729 (Fed. Cir. 1990); *Braun Inc. v. Dynamics Corp. of America,* 24 U.S.P.Q.2d 1121, 1133 (Fed. Cir. 1992).

b. Motorola's Survey Does Not Establish Acquired Distinctiveness

Motorola's survey evidence also does not support a finding of acquired distinctiveness, for at least two reasons.[7] First, as discussed in Nextel's brief, Motorola's survey simply asked the wrong question. *See* Opp. Br. at 19-22, 38-40. Its results therefore cannot be read as reflecting any association of the alleged 911 Hz tone mark with any particular manufacturer. The survey's ultimate question was explicitly limited to knowledge about the manufacturer of a particular radio device that had been identified in an intervening question, and thus provides no evidence about the potential acquired distinctiveness of the alleged mark itself. *See, e.g., American Flange,* 80 U.S.P.Q. at 1415 (question eliciting name of single company most associated with <u>product</u> was irrelevant to whether the product <u>configuration</u> was indicative of a single source); *Boston Beer Co. v. Slesar Bros. Brewing Co. Inc.*, 28 U.S.P.Q.2d 1778, 1781 (1st

[7] Motorola asserts that survey research expert Dr. Jacob Jacoby was unable to state that any of the additional flaws in Motorola's survey, *see* Opp. Br. at 41, had any effect. App. Br. at 42. But Dr. Jacoby's testimony regarding those flaws was as follows: "any one of those in isolation could have a material impact and totally degrade the reliability and validity of the evidence gathered, independent of the major flaws that I mentioned. These by themselves and especially collectively would lead me to place no weight whatever on the evidence gathered." Ex. P, Jacoby Trial Tr., at 51:15-21.

Cir. 1993) (ultimate question asked in such a way that results reflected association "between product and place [*i.e.,* Boston], but not between product and source"). The Motorola survey results, on their face, simply do not provide results that can be used to support any acquired distinctiveness of the 911 Hz tone.

Motorola cites *National Football League Properties, Inc. v. Wichita Falls Sportswear, Inc.,* 215 U.S.P.Q. 175 (W.D. Wash. 1982), and *McNeil-PPC Inc. v. Granutec Inc.,* 37 U.S.P.Q.2d 1713 (E.D.N.C. 1995) for the proposition that a secondary meaning survey may be designed to test the association between a product and a source rather than between the alleged mark and a source. App. Br. at 38-39. But both of those cases were infringement cases involving a particular combination of product features (a football jersey that had the alleged mark – a team, city, or player name – plus official team colors, a large number, and a sleeve design in the *NFL* case) and trade dress (Tylenol's red and yellow gelcap colors in the *McNeil-PPC* case), and the survey respondents were shown the products themselves as a first step in a likelihood of confusion analysis. *See NFL,* 215 U.S.P.Q. at 179; *McNeil-PPC,* 37 U.S.P.Q.2d at 1716.

Second, the survey results, even if valid, would show that only 11 percent of responses identified Motorola, which is simply too small a percentage to establish acquired distinctiveness. *See, e.g.,* Rudolf Callman, Unfair Competition, Trademarks and Monopolies, § 20:30 at 351-355 (4^{th} ed. 2005). Motorola asserts that its survey result was 42 percent rather than only 11 percent, by adding the 24 percent of respondents who identified Nextel, <u>not</u> Motorola.[8] *See* App. Br. at 34-36. But Motorola's reliance on the *Tone Brothers* decision, *Tone Brothers v. Sysco Corp.*, 31

[8] Motorola also adds 7 percent of respondents who named <u>both</u> Nextel and Motorola, which even Dr. Rappeport admits are references to "specific" rather than "single" sources. Ex. N, Rappeport Trial Tr., at 35:22 through 36:7.

U.S.P.Q.2d 1231 (Fed. Cir. 1984), and the "anonymous source rule" to seek credit for these Nextel responses, App. Br. at 42-45, is flatly wrong in this context.

In *Tone Brothers*, the Federal Circuit stated that "[t]he anonymous source rule is directed to the situation where a typical buyer <u>would not know</u> the corporate identity of the source." *Id.* at 1329 (emphasis added). Motorola has admitted, however, in connection with its arguments that it has used the 911 Hz tone as a mark, that customers experience the 911 Hz tone solely with "this branded radio that has Motorola written all over it," Ex. O, Klein Trial Tr., at 17:2-3, 18:23 through 19:8, and that this is a situation in which a typical buyer would know the corporate identity of the source of the radios. Ex. N, Rappeport Trial Tr., at 61:6-11. Motorola cannot credibly argue, on one hand, that the tone is used as a mark because consumers always experience it in the presence of the Motorola house marks, and, on the other hand, that consumer identification of another company's mark inures to Motorola's benefit for purposes of acquired distinctiveness. Motorola's own survey indicates that only <u>11 percent of respondents</u> identified Motorola as the sole source of the two-way radios in a situation in which a typical buyer <u>would know</u> the corporate identity of the source. This is far below what is required to establish secondary meaning. *See, e.g., American Flange*, 80 U.S.P.Q.2d at 1415.

Moreover, Motorola's argument conveniently ignores that the Federal Circuit in *Tone Brothers* – involving an appeal of a summary judgment determination – took "no position as to inferences [that] can be drawn from the data contained in the [survey]." 31 U.S.P.Q.2d at 1330. Instead, the Federal Circuit held that "factual issues need to be addressed on remand." *Id.* This is far from the conclusive determination that Motorola implies resulted from the *Tone Brothers* decision.

Nor are the additional decisions cited by Nextel inconsistent with the *Tone Brothers* decision. In *American Flange*, the Board rejected applicant's survey for several reasons, including flaws in the form of the questions themselves. 80 U.S.P.Q.2d at 1413. But Motorola's assertion that "there is nothing in *American Flange* that requires ignoring or subtracting answers that identify an incorrect entity as the source behind a mark," App. Br. at 44, is hard to understand, given the explicit language by the Board. *See American Flange*, 80 U.S.P.Q.2d at 1414. Simply put, *American Flange* – like the instant case – was not a case in which the "typical buyer would not know the corporate identity of the source." *See Tone Bros.*, 31 U.S.P.Q.2d at 1329. The logic of *American Flange* applies with equal force to Motorola's effort to claim credit for survey answers in which Motorola is not even identified.

The district court cases cited by Nextel are to similar effect. The *Lund* decision, for example, explicitly acknowledged that the anonymous source rule "protects companies with a valid trademark in cases where the public may not know the [owner] by name." *I.P. Lund Trading ApS v. Kohler Co.*, 56 U.S.P.Q.2d 1776, 1788 (D. Mass. 2000). In that particular case, the survey respondents were knowledgeable salespeople and the competing products were distributed under the names of their respective sources. Where nearly half of respondents identifying the product with a single source identified one of plaintiff's competitors as its source, the court found the evidence insufficient to permit the plaintiff to assert exclusive rights in the alleged design mark against that defendant. *Id.* at 1789. Here, Motorola asserts that users associate the tone with a Motorola product, based on consistent exposure to the Motorola house marks. Under these circumstances, the "anonymous source" rule is also inapplicable here.

Indeed, the very commentator that Motorola cites in support of its erroneous argument makes the same point, in the two pages following the one Motorola saw fit to provide to the

Board. *See* Vincent N. Palladino, *Secondary Meaning Surveys in Light of Lund*, 91 Trademark Rep. 573, 615-16 (2001) (attached as Appendix 1). The article expressly criticizes Dr. Rappeport's study in *Lund*, for the very same reasons Nextel criticizes his study here:

> . . . one of the plaintiff's two surveys in Lund III seems ill-conceived. According to the Lund III district court, when respondents were shown plaintiff's faucet (among others) and were asked who made it, twenty percent said plaintiff, eighteen percent said defendant, ten percent said some other manufacturer and thirteen percent said one source they could not name. Somewhat remarkably, plaintiff argued that this established secondary meaning because it showed that a majority of respondents (sixty-one percent) believed that the faucet originated from a single source. . . . plaintiff inexplicably relied on answers which showed that relatively few respondents (twenty percent) believed the faucet came from plaintiff and that a majority of respondents (sixty-one percent) identified a number of different companies as the product's source.

Id. at 616.

D. Nextel Has Standing to Oppose Registration

Motorola's argument that Nextel lacks standing to oppose the unwarranted registration of the 911 Hz alert signal is disingenuous at best. Nextel pleaded that it has a "direct commercial interest" in preventing improper registration of the tone (Amended Notice of Opposition, ¶ 12), and that it is "one of the largest providers of cellular telephone and dispatch services in the United States," and uses the Nextel Chirp in the sale of those services, including two-way radio services. *Id.* at ¶¶ 1, 11. The trial evidence establishes that among the millions of subscribers to whom Nextel sells services and walkie-talkie phones are public safety sector employees who are also principal customers of Motorola's trunked two-way radios. *See* evidence cited at Opp. Br. at 27-28, 46. Indeed, Motorola itself asserts in its brief that users of its two-way radios also often carry walkie-talkie phones from Nextel.[9] App. Br. at 45.

[9] Motorola omits to say that Nextel also sells devices to its customers, which emit the Nextel Chirp, that are not manufactured by Motorola. Ex. K, O'Reilly Dep., at 23:13-16.

It is the ultimate in chutzpah that Motorola, while arguing that Nextel has no direct commercial interest in this case, is at the same time arguing that the 911 Hz sound has acquired distinctiveness as a Motorola trademark based on survey responses that included more than twice as many "Nextel" responses as "Motorola" responses. App. Br. at 36. In itself, this argument establishes that Nextel, of all parties, has a direct interest in opposing the unwarranted registration of the alert tone to Motorola. Motorola's own evidence further supports that interest. For example, Motorola's survey researcher Dr. Rappeport explained his understanding of his potential respondents' experience as follows:

> our understanding is that the systems are akin to – some of them, in fact, do use Nextel systems
>
> . . .
>
> We understand Nextel makes an akin product; that is, a telephone system with a walkie-talkie option where their name appears on the thing and uses a different – that system uses a different frequency chirp, but it's also used as a chirp.

Ex. N, Rappeport Trial Tr., at 40:6-8, 18-22.

The threshold for finding standing is to be interpreted liberally. *See King Ranch, IP LLC v. GWB, Inc.*, 2007 WL 1144945, at *3 (TTAB April 13, 2007) (attached as Appendix 2). To establish standing, a party must demonstrate that it has a "real interest" in the proceedings and that there is a "reasonable" basis for its belief of damage. *Ritchie v. Simpson*, 50 U.S.P.Q.2d 1023, 1025 (Fed. Cir. 1999). The "real interest" standard is intended to prevent participation by "mere intermeddlers" and permits those with a legitimate interest to proceed in an action. *Id.* at 1025 (citations omitted).

As is clear from the evidence, Nextel has a real and personal interest in opposing Applicant's registration. Motorola argues erroneously that Nextel must show that it has already used the 911 Hz tone. App. Br. at 12. But it is sufficient that Nextel sells walkie talkie products to the same customers to whom Motorola sells its trunked two-way radios, and that it is common for these audio devices to use electronically generated alert tones. *See Anchor Hocking*, 162 U.S.P.Q. at 291. In *Anchor Hocking*, the Board found that direct competition with an applicant is sufficient to demonstrate standing and "all the presumption afforded such a registration will be damaging to opposer since it would preclude it from using" the mark if it ever chose to do so. *Id.*

With respect to Motorola's technical argument that Nextel failed to prove the interest it pleaded, the opposition pleading must be examined in its entirety, construing the allegations liberally. *See Lipton Indus., Inc. v. Ralston Purina Co.*, 213 U.S.P.Q. 185 (CCPA 1982); *Kelly Serv. Inc. v. Greene's Temporaries Inc.*, 25 U.S.P.Q.2d 1460 (TTAB 1992). While Motorola attempts to extract a few lines of the Amended Notice of Opposition and argue that Nextel has not presented evidence on those specific allegations, App. Br. at 8, the Opposition and the evidence, read together, establish that Nextel alleged and proved a "direct commercial interest" in opposing improper registration of the 911 Hz tone. Moreover, Motorola had full notice of Opposer's direct commercial interest through the pleadings, through its own direct knowledge, and through the trial evidence. There can be no surprise or prejudice to Motorola here.

E. Motorola's Evidentiary Objections Are Not Well Taken

Nextel provides its response to Motorola's evidentiary objections, App. Br. at 45-48, in Appendix 3.

III. CONCLUSION

For the reasons stated herein, Nextel respectfully requests that the Board sustain Nextel's Opposition and refuse registration of the 911 Hz tone.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true copy of OPPOSER'S REPLY TO APPLICANT'S BRIEF was served on counsel for Motorola on the 30th day of April, 2007, by e-mail and by first class mail to:

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APPENDIX 1

C

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Articles and Reports

*573 SECONDARY MEANING SURVEYS IN LIGHT OF LUND

Vincent N. Palladino [FNa1]

I. INTRODUCTION

Three related decisions involving product features [FN1] raise basic questions about how to assess secondary meaning, including the techniques that should be used in surveying that issue. In the seriousness of certain misconceptions, the Lund decisions may rival the Ninth Circuit's misguided purchaser motivation test, which briefly, but genuinely, unnerved the trademark community twenty years ago. [FN2]

The issue in Lund was whether defendant's sale of a faucet that resembled plaintiff's faucet violated trademark (trade dress) rights plaintiff claimed to have in certain allegedly non-functional features of its faucet. In Lund I, the district court awarded plaintiff a preliminary injunction on a dilution theory and dismissed plaintiff's infringement claim. The First Circuit in Lund II affirmed dismissal of the infringement claim, reversed the preliminary injunction award and remanded the case. In Lund III, the district court held that plaintiff was not entitled to relief on a motion for summary judgment on the dilution claim.

Lund II and Lund III ignore or misstate the issues that are involved in surveying secondary meaning. As a result, the Lund III district court approved a fundamentally flawed survey technique, which fails to distinguish among the concepts of *574 secondary meaning, the aesthetic appeal of product features and aesthetic functionality. The Lund III survey technique requires respondents to speculate about why the designer of a product feature made the feature look the way it does. This "designer motivation" test is hopelessly removed from the question that a secondary meaning survey is intended to address: whether a claimed trademark, including a non-functional product feature, has come to identify the products of one company in the public mind as a result of use in the market place.

This article explores the principles that underlie the doctrine of secondary meaning; observes that surveying secondary meaning is different from surveying aesthetic appeal or aesthetic functionality; discusses Lund II and Lund III in light of these principles; and examines what may lie beyond primary significance as a measure of secondary meaning.

II. THE MEANING OF SECONDARY MEANING

In order to survey secondary meaning and avoid surveying some other issue, a survey must take account of the meaning of secondary meaning. In particular, it should recognize two principles: First, a word, name, symbol or device that lacks inherent distinctiveness (1) acquires such distinctiveness (secondary meaning) when, (2) through association in the public mind with the goods of one producer, the word, name, symbol or device is perceived (3) primarily as an identifier of the goods of one producer, whether known or unknown, and (4) not primarily as a descriptive or generic term or a decorative feature. Second, it is irrelevant to this distinctiveness inquiry whether the public regards a decorative feature as either aesthetically pleasing or aesthetically functional. [FN3]

This follows from the conclusions, discussed in this section of the article, that:

(1) An understanding of secondary meaning begins with the definition of a trademark. The definition differentiates among the various potential subjects of a trademark (a word, name, symbol or device), goods (which the trademark identifies and distinguishes from the goods of others) and the goods' producer (which the *575 trademark indicates by identifying and distinguishing goods). The definition also incorporates the anonymous source rule;

(2) A word, name, symbol or device that is capable of being a trademark, but lacks inherent distinctiveness, becomes a trademark when it acquires the distinctiveness that characterizes a trademark, namely, the ability to indicate the source of goods by identifying the goods and distinguishing

them from the goods of others, without necessarily naming the source;

(3) On the issue of acquired distinctiveness, the law does not distinguish among words, names, symbols or devices, including product features;

(4) A word, name, symbol or device acquires distinctiveness when it becomes associated in the public mind with the goods of one producer;

(5) The notion that association, without more, establishes acquired distinctiveness is consistent with the definition of a trademark including the anonymous source rule;

(6) Primary significance is a measure of the extent of association of a word, name, symbol or device with the goods of one producer, not a separate test for determining whether a word, name, symbol or device has acquired distinctiveness;

(7) Primary significance is an overall measure of the public's primary perception concerning the status of a word, name, symbol or device in relation to goods, not an inquiry into each individual's primary perception;

(8) Once one determines the public's primary attitude regarding association of a word, name, symbol or device with goods, the distinctiveness inquiry ends; and

(9) Public perceptions concerning whether or not a product feature is decorative, aesthetically pleasing or aesthetically functional are three different perceptions, and the relationship between acquired distinctiveness and each of these perceptions differs.

A. The Definition of a Trademark

A trademark is "any word, name, symbol, or device, or any combination thereof" that a person uses or in good faith intends to use in commerce "to identify and distinguish his or her goods, including a unique product, from those manufactured or sold by others and to indicate the source of the goods, even if that source is unknown." [FN4]

***576** The definition distinguishes among (1) the subject of a trademark (which may be a word, name, symbol or device), (2) goods and (3) those who produce goods. Not every word, name, symbol or device is a trademark. A word, name, symbol or device is a trademark only when it bears a certain relationship to goods, i.e., only when it identifies the goods of one producer and distinguishes them from the goods of other producers. Inherent in this is the notion that a word, name, symbol or device will not be a trademark if the public perceives that more than one producer of a certain type of goods uses it.

As used in the definition, the concepts "to identify and distinguish" goods and "to indicate the source of the goods" do not refer to different functions that a trademark performs. Rather, a trademark indicates the source of goods by identifying the goods of one producer and distinguishing them from the goods of others. [FN5]

Notably absent from the definition is any requirement that a trademark name or otherwise "identify" the source (producer) of goods. A trademark "identif [[ies] ... goods" (that originate with a producer) and, thereby, distinguishes those goods from other goods (that originate with other producers). It is by doing this (identifying and distinguishing goods) that the trademark "indicates" the producer of the goods. Put another way, there is a connection or association between a word, name, symbol or device and goods (from one producer), not between a word, name, symbol or device and the producer to the exclusion of or apart from the producer's goods.

This may be illustrated by an example in which the trademark is a word ("X"), the competing products of several producers are circles and the producers of the products are squares. The word serves as a trademark when it identifies and distinguishes the products of one producer:

> ***577** It is in this way, and this way only, that the word "indicates" the producer. There is no requirement that the word actually name or otherwise "identify" the producer of the product, and it would be contrary to the definition of a trademark to require the word to perform that function: Finally, the claimed trademark will not be a trademark if it is used on the competing products of more than one producer:

***578** *B. Becoming a Trademark by Acquiring Distinctiveness*

A word, name, symbol or device that is capable of being a trademark, [FN6] but lacks inherent distinctiveness, becomes a trademark when, in the public mind, it acquires the distinctiveness that characterizes a trademark, namely, the ability to indicate source by identifying the goods of one producer and distinguishing them from the goods of others:

> [O]ver time, customers may come to treat a particular color on a product or its packaging ... as signifying a brand. And, if so, that color would have come to identify and distinguish the goods-i.e., "to indicate" their "source"-much in the way that descriptive words on a product ... can come to indicate a product's origin. In this circumstance, trademark law says that the word ..., although not inherently distinctive, has developed "secondary meaning." See Inwood Laboratories, Inc. v. Ives Laboratories, Inc., 456 US 844, 851, fn 11 (1982) ("secondary meaning" is acquired when "in the minds of the public, the primary significance of a product feature ... is to identify the source of the product rather than the product itself"). [FN7] This may be illustrated by another example in which the claimed trademark is a word ("X"), the competing products of several producers are circles and the producers of the products are squares. If the word is not inherently distinctive, it has a meaning in the language apart from the products and from the producers:

***579** However, if as a result of use by one producer [FN8] the public comes to connect or associate the word with the products of that producer, the word identifies and distinguishes those products in the same way an inherently distinctive word mark does from the outset, and is thus said to take on a "secondary meaning":

> It is in this way, and this way only, that the word "indicates" the producer. There is no requirement that the word actually name or otherwise "identify" the producer of the product, and it would be contrary to the definition of a trademark to require the word to perform that function: ***580** Finally, in keeping with the definition of a trademark, the claimed trademark will not acquire secondary meaning if it becomes connected or associated with the competing products of more than one producer:

C. Words, Names, Symbols and Devices Are Treated Alike

When it comes to acquired distinctiveness (secondary meaning), the law does not distinguish among words, names, symbols or devices, including product features. This is evident from the Supreme Court's decisions in Qualitex, which equated the color of a product with a descriptive word; [FN9] Two Pesos, Inc. v. Taco Cabana, Inc.:

> "To establish secondary meaning, a manufacturer must show that, in the minds of the public, the primary significance of a *product feature or term* is to identify the source of the product rather than the product itself." Inwood Laboratories, Inc. v. Ives Laboratories, Inc., 456 US 844, 851, fn 11 (1982); [FN10] Inwood Laboratories, Inc. v. Ives Laboratories, Inc.:

> To establish secondary meaning, a manufacturer must show that, in the minds of the public, the primary significance of a *product feature or term* is to identify the source of the product rather than the product itself. See Kellogg Co. v. National Biscuit Co., supra, at 118; [FN11] and Kellogg Co. v. National Biscuit Co.:

> ***581** Where an article may be manufactured by all, a particular manufacturer can no more assert exclusive rights in a *form* in which the public has become accustomed to see the article and which, in the minds of the public, is primarily associated with the article rather than a particular producer, than it can in the case of a *name* with similar connections in the public mind. [FN12] Summing up the state of the law, the Restatement Third, Unfair Competition, reports:

> [In addition to words, the] concept of secondary meaning is also applicable to designations such as graphic designs, symbols, packaging features, and product designs. [FN13] This may be illustrated by an example in which the claimed trademark is a non-functional product feature ("X") rather than a word, the competing products of several producers are circles and the producers of the products are squares. Because the product feature is not inherently distinctive, it effectively exists for trademark purposes apart from the products and from the producers:

> If this seems troubling conceptually, it should not be. A non-functional feature of a product, the product itself and the producer ***582** of the product are three different things. [FN14] Moreover, as with a descriptive word, association by the public of a non-functional

feature with the products of only one producer takes time. If the public comes to connect or associate the feature with the products of one producer, the feature identifies and distinguishes the products in the same way an inherently distinctive mark does from the outset and is thus said to take on a "secondary meaning":

It is in this way, and this way only, that the feature "indicates" the producer. There is no requirement that the feature actually name or otherwise "identify" the producer of the product, and it would be contrary to the definition of a trademark to require the feature to perform that function: Finally, in keeping with the definition of a trademark, the feature will not acquire secondary meaning if it becomes connected or associated with the competing products of more than one producer:

***583** The Supreme Court's decision in Wal-Mart Stores, Inc. v. Samara Brothers, Inc. [FN15] is not to the contrary. In distinguishing between product features on the one hand and word marks and packaging on the other, the Court addressed "inherent distinctiveness," [FN16] not acquired distinctiveness (secondary meaning). On the latter issue, the Wal-Mart Court quoted with approval [FN17] the passage from Inwood Laboratories cited above about how a product feature or term can be shown to have acquired secondary meaning. [FN18]

D. Association as the Means of Acquiring Distinctiveness

Repeatedly, the law has affirmed that a word, name, symbol or device acquires distinctiveness (secondary meaning) when it becomes associated in the public mind with the products of one producer.

In Kellogg, after setting out the test for secondary meaning discussed above, [FN19] the Supreme Court held that the shape of the product at issue - like its generic name - could not be considered a trademark because "in the minds of the public, [it] is primarily *associated* with the article rather than a particular producer." [FN20] ***584** Since then, most courts have come to agree that secondary meaning is "'association nothing more'" [FN21] and that the association is between "certain words, symbols, collocations of colors and designs ... [and] goods from a single source." [FN22]

More than a half century after Kellogg, the Supreme Court in Two Pesos reaffirmed that "[s]econdary meaning is used generally to indicate that a mark or dress 'has come through use to be uniquely *associated* with a specific source.' Restatement (Third) of Unfair Competition § 13, Comment e (Tent. Draft No. 2, Mark 23, 1990)." [FN23]

The Restatement Third, Unfair Competition explains:

A designation that is not inherently distinctive, such as a word that describes the nature of the product on which it appears, nevertheless may become, as a result of its use by a specific person, uniquely *associated* with *that person's goods*, services, or business. Such acquired distinctiveness is called "secondary meaning." ... The concept of secondary meaning is also applicable to designations such as graphic designs, symbols, packaging features, and product designs. [FN24] This association of a word, name, symbol or device with the products of one producer is illustrated by the diagrams in supra Sections II.B. and C. which in turn track the definition of a trademark, illustrated by the diagrams in supra Section II.A.

E. Association With an Anonymous Source

The notion that association of a word, name, symbol or device with the products of one producer establishes acquired distinctiveness (secondary meaning) is consistent with the definition of a trademark that includes the anonymous source rule. It is fundamental to both the definition of a trademark and secondary meaning that a trademark need not identify the producer of a product by name. [FN25] A trademark is a word, name, symbol or ***585** device that indicates the source of goods "even if that source is unknown." [FN26] Similarly, a word, name, symbol or device acquires secondary meaning if it indicates the source of goods "whether [that source is] known or anonymous." [FN27]

"Association" of a word, name, symbol or device with the products of one producer takes this into account because it requires a connection or association in the public's mind between the word, name, symbol or device and the products of one producer without requiring the word, name, symbol or device to identify the producer of the products by name. This is illustrated by the diagrams in supra Sections II.B. and C. These diagrams show a connection or association of a word, name, symbol or device with the products of one producer and not with a named producer apart from the products. This, in turn, tracks the definition of a trademark, as illustrated by the diagrams in supra Section II.A.

F. Primary Significance as a Measure of Association Between Trademark and Goods

This section demonstrates two propositions. First, the so-called primary significance test is a measure of the extent of association, not a separate test for determining whether a word, name, symbol or device has acquired distinctiveness (secondary meaning). Second, the association it seeks to measure is association of a word, name, symbol or device with the products of one producer, not association of a word, name, symbol or device with a named producer of the products apart from the products themselves.

1. Primary Significance as a Measure of Association

a. Two Pesos

Support for the view that primary significance is a measure of association, rather than a separate test for acquired distinctiveness (secondary meaning), may be found in Two Pesos, where the Supreme Court observed:

> Secondary meaning is used generally to indicate that a mark or dress "has come through use to be uniquely associated with a specific source." Restatement (Third) of Unfair Competition § 13, Comment e (Tent. Draft No. 2, Mar. 23, 1990). "To establish secondary meaning, a manufacturer must show that, in the minds of the public, the primary significance ***586** of a product feature or term is to identify the source of the product rather than the product itself." Inwood Laboratories, Inc. v. Ives Laboratories, Inc., 456 US 844, 851, fn 11 (1982). [FN28] The juxtaposition of these two sentences - one referring to association and the other to primary significance - makes little, if any, sense unless primary significance is a measure of association, not a separate test for acquired distinctiveness. It would be anomalous for the Court to have set out, back-to-back, two different tests for addressing the same issue. More logically, the second sentence regarding primary significance is an explication of the first sentence regarding association, namely, a statement of the extent to which association must be established before secondary meaning will be inferred.

This is borne out by the sentences themselves. The first sentence states what secondary meaning "is" and defines it as a "unique ... association" between a mark or dress that is used on goods and a specific source of the goods. "Unique" refers to association between a mark/dress and only one ("specific") source of goods (as opposed to association between a mark/dress and more than one source of goods or no source of goods). "Unique" is not a measure of the extent to which the public as a whole makes the association, i.e., there is no requirement that every member of the public make the association. Unlike the first sentence, the second sentence does not define secondary meaning. Instead, it sets out what must be shown to "establish" secondary meaning. In doing so, it sets out a measure of the extent to which the public must make the association (referred to in the first sentence). Accordingly, secondary meaning is established (acquired) if single source identification is the "primary" association (significance) in the public mind.

b. Kellogg

Kellogg - where the term "primary significance" originated - also supports the view that primary significance is a measure of the extent of association, rather than a separate test for acquired distinctiveness (secondary meaning).

The evidence in the case showed that for "many years, there was no attempt to use the term 'Shredded Wheat' as a trademark"; [FN29] "shredded wheat" was "the generic term of the article ... by which the biscuit in pillow-shaped form is *generally* known ***587** by the public"; [FN30] and the pillow-shaped form "in the minds of the public, is *primarily associated* with the article rather than a particular producer." [FN31]

On that record, the Court concluded that plaintiff was not entitled to exclusive trademark/trade dress rights in either the term "shredded wheat" or the pillow-shape form. There is nothing in this decision to suggest that "primary significance" was anything other than "primary association."

Despite the evidence of record discussed above, [FN32] plaintiff argued that it was entitled to trademark protection for the term "shredded wheat" because the term allegedly had acquired a secondary meaning: "*many* people have come *to associate* the product, and as a consequence the name by which the product is *generally* known, with the plaintiff's factory at Niagara Falls." [FN33] Responding to this argument, the Court held that this evidence of association by many people of the term with plaintiff's factory was inadequate to establish that the term "shredded wheat" had taken on a secondary meaning among the consuming public because:

> to establish a trade name [secondary meaning] in the term "shredded wheat" the plaintiff must show more than a subordinate meaning [association] which applies to it. It must show that the primary significance [[meaning/association] of the term in the minds of the consuming public is not the product but the producer. [FN34] The last sentence is the often-cited source of the so-called primary significance test.

That sentence should not be read in isolation or apart from the facts of the case and the language that immediately precedes it, including the reference to "association ... by people of the term with [plaintiff]." Nor should it be regarded as a rejection of "association" as the means of acquiring secondary meaning in favor of some means other than association that the Court nowhere explained. Instead, Kellogg should be understood to say that a "subordinate" meaning (association by "many" people) does not trump a "primary" meaning (association by the public "generally").

If the Court had intended to jettison association as the means of acquiring secondary meaning and replace it with a different means, it could easily have done so. For example, in response to ***588** plaintiff's argument, it could have said that "association of the term 'shredded wheat' with plaintiff or its factory is not the issue," and have gone on to define the issue. But the Supreme Court did not do that. Instead, the Supreme Court spoke in terms of "subordinate" and "primary" meanings (associations).

c. Other Authorities

The relationship between secondary meaning and genericness also supports the view that primary significance is a measure of the extent of association, rather than a separate test for acquired distinctiveness (secondary meaning).

The Restatement Third, Unfair Competition ties both secondary meaning and genericness to public perception of the claimed trademark, indicating that they are in effect two sides of one coin:

C1Secondary Meaning (§ 13)
[A designation acquires secondary meaning when] prospective purchasers have come to perceive it as a designation that identifies goods [produced or sponsored by a particular person, whether known or unknown]. [FN35]

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The Restatement Third, Unfair Competition then goes on to explain that "[t]he 'primary significance' standard [applied to generic designations] is often traced to the Supreme Court's decision in Kellogg Co., supra, although the phrase there appears in the context of a discussion of *secondary meaning* .... The standard is often interpreted as a rule of majority usage." [FN37]

Among the authorities cited in the Restatement Third, Unfair Competition for this proposition is McCarthy on Trademarks and Unfair Competition, which explains:

> ***589** The standard most often applied to determine whether a term is generic is not whether it has *some* significance to the public as the name of an article, but whether that is its *principal* significance. However, the Supreme Court turned this statement around and said that for a seller to prove trademark significance in a term challenged as generic, it must be proven that the "*primary* significance of the term in the minds of the consuming public is *not* the *product* but the *producer*." But both word formulations arrive at the same result from different directions: Majority usage of the word is controlling.
>
> The point seems to be that where some customers regard the term as generic, while others regard it as a mark, the term must be placed either in the "generic" pigeonhole or in the "trademark" category. For example, if a survey showed that 75 percent of the public regarded the word as generic, then that is its "principal significance." [FN38]

2. Association Between Trademark and Goods

It is not illogical to conclude that a designation acquires secondary meaning when - to track Restatement Third, Unfair Competition Sections 13 and 15 - the designation "has become distinctive, in that ... prospective purchasers have come to perceive it [primarily] as a designation that identifies goods" "produced or sponsored by a particular person, whether known or anonymous" [FN39] rather than "primarily as a generic designation for the category, type, or class of the goods" or primarily as a descriptive word or name or a decorative symbol or device that does not identify goods produced or sponsored by a particular person, whether known or unknown, because it is associated with others' goods. [FN40]

***590** The phrase "primary significance of the term in the minds of the consuming public is not the product but the producer" [FN41] should not be taken to mean that the primary significance of the term in the minds of the consuming public must not be the product, but a named producer. Similarly, the phrase "primary significance of a product feature or term is to identify the source of the product rather than the product itself" [FN42] should not be taken to mean that the primary significance of a product feature or term must be to identify *by name* the source of the product rather than the product itself. Rather, both phrases should be read as: primary association of a product feature or term with the products of one, perhaps anonymous producer, rather than with a category, type or class of products that do, or at least could, originate with more than one producer. [FN43]

The foregoing is consistent with the definition of a trademark, which requires a connection or association of a claimed trademark ("X") with the products of one producer (circle):

> not with a named producer (square), apart from the producer's products: ***591** On this point, the Supreme Court's Qualitex decision is instructive:
>
> [O]ver time, customers may come to treat a particular color on a product or its packaging ... [as] identify[ing] and distinguish[ing] the goods - i.e., "... indicat[ing]" their "source" ... See Inwood Laboratories, Inc. v. Ives Laboratories, Inc., 456 US 844, 851, fn 11 (1982) ("secondary meaning" is acquired when "in the minds of the public, the primary significance of a product feature ... is to identify the source of the product rather than the product itself"). [FN44] Here, an explanation of secondary meaning that properly tracks the definition of a trademark (customers treating a product feature as identifying and distinguishing goods and, thereby, indicating their source) is followed by the traditional statement regarding primary significance. The two statements cannot stand side-by-side unless the statement regarding primary significance conforms to the definition of a trademark, which is referenced in the explanation of secondary meaning that immediately precedes it.

When the Ninth Circuit departed from these basic principles twenty years ago by focusing on the presence or absence of source-particular criteria in consumers' minds, it unleashed the purchaser motivation test that Congress subsequently rejected by amending the Lanham Act. [FN45]

G. Primary Significance as a Measure of Public Perception

The foregoing also indicates that primary significance is an overall measure of the *public's* primary perception concerning the status of a claimed trademark, not an inquiry into *each individual's* primary perception. [FN46] Each member of the relevant public is deemed to have a view as to whether a claimed trademark identifies or does not identify the goods of one producer, and the legal status of the claimed trademark turns on the number of people who hold one or the other of those mutually exclusive views. Each member of the public is not held to entertain both of those contradictory views simultaneously. By necessity, no inquiry is made as to whether each member of the public primarily holds one view or the other.

Put another way, each respondent is asked, in effect: "Do you, or do you not, regard the word, name, symbol or device as a ***592** trademark?" Each respondent is not told: "We understand that you believe that this word, name, symbol or device is both a trademark and not a trademark. However, what we want to know is which of these two beliefs is your primary belief?" By analogy, the first question asks "for whom did you vote?" and gives the election to the candidate who receives the most (primary number) of votes, whereas the second question asks "although you like both candidates, which of them do you prefer?," i.e., "which of them do you primarily like?"

H. Association Ends the Inquiry

Once one determines the public's primary attitude regarding association of a word, name, symbol or device with goods, the distinctiveness inquiry ends. The word, name, symbol, or device either identifies the goods of one producer (because it is primarily associated with that producer's goods) or it does not. Further inquiry into public attitudes regarding the word, name, symbol or device are irrelevant *to the distinctiveness issue*. It does not matter whether, in addition to associating a word or design with the products of one producer (or not making that association), the public also finds the word pleasing to the ear or the design attractive to the eye. [FN47] Equally irrelevant to the distinctiveness issue are public attitudes about a different issue: the functionality of a product feature. [FN48]

I. Public Perception of Product Features

The public may regard a product feature as decorative (ornamental), aesthetically pleasing (appealing) or aesthetically functional. From a trademark perspective, the relationship between acquired distinctiveness and each of these three types of public perceptions differs.

1. Decorative (Ornamental) Features

A product feature may be perceived as decorative (ornamental) by the public. Among those members of the public who regard the feature as decorative (ornamental), some may find the decorative (ornamental) feature pleasing (appealing) - i.e., they like the way it looks - and others may not. If the public perceives a feature to ***593** be decorative (ornamental), the feature will be denied trademark status for lack of distinctiveness [FN49] (whether or not the public likes the way the feature looks). However, a decorative (ornamental) feature can acquire distinctiveness if the public comes to perceive it as a trademark by associating it with goods from a single source (whether or not the public likes the way the feature looks). [FN50] Whether the decorative (ornamental) feature does or does not identify goods from one source is a different issue from whether the feature is aesthetically functional. [FN51]

2. Aesthetically Pleasing (Appealing) Features

From a trademark perspective, "aesthetically pleasing" (or "aesthetically appealing") is not a term of art. An aesthetically pleasing product feature is simply one that the public finds pleasing (appealing), i.e., the public likes the way it looks. But that perception - of concern, perhaps, to marketers - is irrelevant to whether the feature is perceived as distinctive, [FN52] for an ugly feature can be as much an indicator of source as an attractive one. Nor is an aesthetically pleasing feature necessarily an aesthetically functional feature:

> When aesthetic considerations play an important role in the purchasing decisions of prospective consumers, a design feature that substantially contributes to the aesthetic appeal of a product may qualify as "functional." As with utilitarian design features, however, the fact that the design performs a function by contributing to the aesthetic value of the product does not in itself render the design ineligible for protection as a trademark. A *manufacturer thus does not forfeit trademark rights simply because prospective purchasers find the design aesthetically pleasing.* A design is functional because of its aesthetic value only if it confers a significant benefit that cannot practically be duplicated by the use of alternative designs. [FN53]***594**

3. Aesthetically Functional Features

It goes almost without saying that acquired distinctiveness (secondary meaning) and functionality are different issues. [FN54] "Public acceptance of a functional feature as an indication of source, even as evidenced by a consumer survey, is not determinative of trademark rights in functional features." [FN55] To the extent that the doctrine of aesthetic functionality retains any vitality, [FN56] the distinction between secondary meaning and functionality applies to it as well:

> Keene argues that the court's finding that its product had acquired a secondary meaning is inherently inconsistent with the court's finding of aesthetic functionality. However, we see nothing inconsistent between a finding that a distinctive design has become sufficiently identified with its original producer to serve as an indication of its source and a finding that the design is nonetheless not insignificantly related to its utilitarian function. This is amply supported by case law .... The courts have generally treated the issue of functionality, including aesthetic functionality, as a separate consideration from secondary meaning. [FN57]

If the public perceives the appearance of a product feature to be functional, the feature will be denied trademark status, whether or not the feature has acquired distinctiveness. For example, in Deere & Co. v. Farmland, Inc., [FN58] the court held that defendant Farmland had the right to paint its loaders a shade of green that plaintiff John Deere claimed was its trademark because "farmers prefer to match their loaders to their tractor ... [and thus] protection of John Deere green ... would hinder Farmland in competition" [FN59] by making it more difficult for Farmland to sell its loaders to farmers. That aspect of farmers' perception of John Deere green was properly considered in deciding whether John Deere green was functional, [FN60] wholly apart from the separate *595 question of whether John Deere green had acquired distinctiveness (secondary meaning) among farmers. [FN61]

4. Relationship to Acquired Distinctiveness

From a trademark perspective, the relationship between acquired distinctiveness, on the one hand, and decorativeness, aesthetic appeal or aesthetic functionality, on the other, differs. Acquired distinctiveness and decorativeness are mutually exclusive. If a feature that the public considered decorative acquires distinctiveness by association with the products of one producer, distinctiveness (secondary meaning) supplants decorativeness (original meaning), just as the acquired distinctiveness (secondary meaning) of a word supplants descriptiveness (original meaning). Acquired distinctiveness and aesthetic appeal, however, are not mutually exclusive. The public may regard a feature as distinctive and also appealing (attractive) or unappealing (unattractive). Finally, acquired distinctiveness and aesthetic functionality are not mutually exclusive. The public may regard a feature as distinctive and also aesthetically functional or non-functional.

In short, a feature may be regarded by the public as:

Distinctive or Decorative
and
Appealing or Unappealing
and
Functional or Non-functional

III. SURVEYING SECONDARY MEANING DIFFERS FROM SURVEYING AESTHETIC APPEAL OR AESTHETIC FUNCTIONALITY

The foregoing principles lend support to the basic survey approach discussed in Surveying Secondary Meaning, [FN62] and they distinguish surveys of secondary meaning from surveys of aesthetic appeal or aesthetic functionality. The issue in a secondary meaning (acquired distinctiveness) survey is whether the public associates a claimed trademark with goods from a single, perhaps anonymous, source. It is not whether the public finds the claimed trademark aesthetically pleasing (appealing) or aesthetically functional.

*596 *A. Surveying Secondary Meaning*

Surveying Secondary Meaning concluded that a secondary meaning survey should present respondents with the claimed trademark (word, name, symbol or device). [FN63] It then observed:

> In order to track the accepted definition of secondary meaning, including the anonymous source rule, a proper question should seek to determine whether or not a claimed trademark ... is associated with plaintiff's product without asking respondents to give plaintiff's name. Without endorsing any specific language, the question could be: 1. Do you associate [claimed trademark] with [product identification] of one, or more than one, company? [FN64]

> and went on to say: When that question is put to respondents, one could urge that secondary meaning will be inferred if over half of the respondents say "the product of one company" and will not be inferred if over half say "the product of more than one company." In other words, the primary significance of a term is the view of a majority of respondents, where respondents are given a choice between two mutually exclusive alternatives. [FN65] This basic approach also applies where the claimed trademark is a decorative (ornamental) product feature:

> Do you associate [decorative product feature] with [product identification] of one, or more than one, company? This basic approach also takes account of the principles discussed in Section II of this article. For one thing, it tracks the definition of a trademark. In keeping with that definition, it incorporates the basic notion that a claimed trademark (word, name, symbol or device) differs from products and from the producers of products. It does this by isolating the claimed trademark to which the survey question is directed and by distinguishing, in the question, among (1) the claimed trademark, (2) the type of products at issue and (3) the company or companies that make such products:

> Do you associate [(1) claimed trademark] with [(2) product identification] of [3] one, or more than one, company? *597 It also recognizes the notion, inherent in the definition of a trademark, that a claimed trademark will not be a trademark if the public knows it is used on the competing products of more than one producer. Further, it incorporates the anonymous source rule from the definition because it does not ask respondents to name the company that makes

the products. Finally, it does not distinguish among words, names, symbols or devices, including product features. Instead, it recognizes that any of these can be a trademark.

In keeping with the definition of a trademark, this survey approach also recognizes that a word, name, symbol or device that is capable of being a trademark (claimed trademark), but lacks inherent distinctiveness, becomes a trademark when it acquires the distinctiveness that characterizes a trademark, namely, the ability to indicate the source of goods by identifying only those goods and distinguishing them from the goods of others, without necessarily naming the source. To establish secondary meaning, the survey must show that there is a connection or association between the claimed trademark and the goods of only one (unnamed) company.

The survey also treats primary significance as a measure of the extent of association of a claimed trademark with the products of one producer, not as a separate test for determining whether the claimed trademark has acquired distinctiveness. Respondents are asked whether they associate the claimed trademark with the products of one or more than one company. If the primary association (significance) is between the claimed trademark and the products of only one company, the claimed trademark has acquired secondary meaning, and vice versa. In this way, the survey also recognizes that primary significance is an overall measure of the public's primary perception concerning the status of a claimed trademark, not an inquiry into each individual's primary perception.

Further, the survey recognizes that once one determines the public's primary attitude regarding association of a claimed trademark with goods, the distinctiveness inquiry ends. The survey does not go on to ask about issues other than acquired distinctiveness, including whether or not the public considers a claimed product feature trademark aesthetically pleasing or aesthetically functional.

The synthesis of these principles may be shown in an example. Where "X" is the claimed trademark, the competing products of several producers are circles and the producers are squares, "X" will be a trademark where the survey shows that ***598** more respondents associate it with only one producer's products than associate it with the products of several producers:

More Respondents Associate Trademark X With One Producer's Products

More Respondents Associate Trademark X With Products of Several Producers

That, and that alone, establishes the primary significance (association) of the claimed trademark. Moreover, in no event does the claimed trademark need to identify any producer by name. Finally, once the respondents' primary attitude regarding association is determined, the inquiry ends. Respondents are not asked additional questions concerning their attitudes about the claimed trademark, including whether they find it attractive or functional.

B. Surveying Aesthetic Appeal

Surveying secondary meaning is different from using a survey to determine whether the public finds a claimed trademark - including a product feature - aesthetically pleasing (appealing). ***599** Inquiring about aesthetic appeal asks in effect: "Do you, or do you not, find [the claimed trademark] attractive?" That inquiry does not address either the issue of acquired distinctiveness (secondary meaning) [FN66] or, without more, the kind of restraint on competition that the doctrine of aesthetic functionality addresses. [FN67]

C. Surveying Aesthetic Functionality

Surveying either secondary meaning or aesthetic appeal is different from surveying the aesthetic functionality of a product feature that is claimed to be a trademark. Aesthetic functionality involves how public attitudes about a certain type of claimed trademark (product feature) may or may not affect competition. For example: "Would you, or would you not, be as likely to buy [[product identification] if it did not have this [product feature]?" [FN68]

If respondents say they would be as likely to buy the product without the feature, one might consider this evidence that public perception of the feature does not affect competition in the sale of the product, i.e., the product feature is not aesthetically functional. If respondents say they would be less likely to buy the product without the feature, follow-up questions could be asked to determine why they gave that answer. Some answers might suggest that the feature is aesthetically functional. For example, a farmer might answer that he would be less likely to buy a loader not painted John Deere green because "the loader doesn't match my [John Deere] tractor."

[FN69] He may give that answer although he associates John Deere green with the tractors of only one company, John Deere.

The point here is less the wording of the questions (and interpretation of possible answers) than the basic principle: surveying the effect of consumer perceptions on competition (surveying aesthetic functionality) is different from either surveying secondary meaning or surveying aesthetic appeal.

*600 *D. Confusing the Issues*

Because secondary meaning, aesthetic appeal and aesthetic functionality involve public attitudes about three different issues that are not mutually exclusive, the public's attitude about any one of those issues cannot be dependent upon the public's attitude about the other two issues. Thus, a survey cannot determine whether a claimed trademark has acquired secondary meaning in the public mind by presenting secondary meaning, aesthetic appeal and aesthetic functionality as alternatives and requiring the public to choose among those alternatives.

For example, a survey cannot properly explore secondary meaning in a product feature that a party claims is its trademark by requiring respondents to choose among the following:

> (1) Do you associate [claimed trademark] with [product identification] of one, or more than one, company? or (2) Do you, or do you not, find [claimed trademark] attractive? or (3) Would you, or would you not, be as likely to buy [product identification] if it did not have this [claimed trademark]? The first question addresses secondary meaning, the second addresses aesthetic appeal and the third at least arguably addresses aesthetic functionality. An assessment of secondary meaning turns only on the answers to the first question. It does not turn on the answers to the second and third questions or require respondents to choose the first alternative in lieu of the other two. A respondent can: (1) associate the claimed trademark with the products of only one producer (or not make that association); (2) find the claimed trademark attractive (or not find it attractive); and (3) find the claimed trademark aesthetically functional (or not).

Similarly, a survey cannot properly evaluate secondary meaning in a product feature that a party claims as its trademark by requiring respondents to choose among the following reasons why the feature looks the way it does:

> (1) tells you who made or put out the product, or (2) is pleasing in appearance, or (3) is useful. Only the first option even arguably addresses acquired distinctiveness (secondary meaning), which is concerned with indicating the source of goods (and even then it ignores the anonymous source rule). The second option addresses aesthetic appeal. The third option addresses utility, which is akin to, but not ***601** the same as, functionality. A respondent may entertain none of these three beliefs because he does not regard the feature as a source indicator, finds the feature unattractive and does not consider the feature useful. Or he may entertain all or only some of these beliefs. In any case, the beliefs are not mutually exclusive alternatives, which shed light on acquired distinctiveness only when respondents are forced to choose among them.

The foregoing three-options approach makes no more sense than attempting to determine whether or not respondents recognize a political candidate by showing them a picture of the candidate and requiring them to choose among the following options:

> (1) Do you recognize this person? (2) Do you find this person attractive? (3) Do you believe this person would do a good job if elected? The three options each address different issues. Only the first option addresses the issue that is the subject of the survey. That issue cannot be addressed by forcing respondents to choose among the three options.

IV. THE LUND DECISIONS

A. Lund Goes Astray

In reversing Lund I, the First Circuit in Lund II found the district court's conclusion that plaintiff's faucet features had acquired secondary meaning "doubtful for several reasons." [FN70] One of these reasons, according to the appellate court, was that the district court failed to appreciate that establishing secondary meaning requires proof that:

> something in the design which is not functional serves primarily to signify the

source of the faucet and not primarily to signify that it is an aesthetically pleasing faucet. [FN71] That fundamentally misstates the issue. The issue is not whether the design primarily (1) serves as a trademark ("signif[ies] the source of the faucet") or (2) is "aesthetically pleasing." The issue is whether the design primarily (1) serves as a trademark, because it has become associated in the public mind primarily with goods from only one source, or (2) is primarily regarded by the public as a decoration that does not signify source. [FN72] Because source significance and aesthetic appeal are not mutually exclusive ***602** alternatives, it is irrelevant to the distinctiveness inquiry whether or not the public regards the design as aesthetically pleasing. Some members of the public may like the way the design looks and others may not. But that says nothing about whether they consider it an indicator of source. Put another way, to prove that a claimed trademark has acquired secondary meaning, a party need not prove that the claimed trademark indicates source and, also, that the claimed trademark is not attractive.

Due in part to the First Circuit's misstatement of the issue, the district court in Lund III ran afoul of a number of the basic principles discussed in Sections II and III of this article.

1. Misstating the Secondary Meaning Issue

The district court misstated the secondary meaning issue when it observed:

The central inquiry before this Court is whether, in the minds of the relevant consumers, the primary significance of the ... [faucet] design is to identify the source of the product, Kroin, rather than the product itself. See Samara Bros., 120 S Ct at 1343; Kellogg, 305 US at 120; Lund II, 163 F3d at 41-42. Stated another way: "[S]omething in the ... [faucet] design which is not functional" must serve "primarily to signify the source of the faucet and not primarily to signify that it is an aesthetically pleasing faucet." Lund II, 163 F3d at 42. [FN73] By insisting that the claimed trademark "identify the source of the product, Kroin," the first sentence ignores the definition of a trademark, including the anonymous source rule, and the meaning of primary significance. [FN74] The second sentence repeats the First Circuit's misstatement in Lund II. [FN75] Moreover, the second sentence does not simply "state ... [in] another way" the first sentence. The public's belief that a product feature identifies "the product itself" differs from its belief that the feature is "aesthetically pleasing."

The district court also relied on the Lund II misstatement in rejecting one of plaintiff's surveys:

There can be no secondary meaning if the majority of consumers believe the ... [faucet] comes from a single source, but that same majority of consumers, when asked, believes the ***603** design primarily signifies an "aesthetically pleasing faucet." Lund II, 163 F3d at 42. [FN76] Although the statement is less than clear, it appears to confuse secondary meaning with aesthetic appeal. A majority of consumers *can* believe that a feature has acquired secondary meaning, indicating that goods come from a single source, and also believe that the feature is aesthetically pleasing (attractive). [FN77]

2. Misreading Lund II

In addition to adopting the Lund II misstatement, the district court misread Lund II, stating that to prove secondary meaning:

The evidence must also prove that consumers view the ... [faucet] design primarily as a brand-identifier - and not as an aesthetically pleasing or useful faucet design. Lund II, 163 F3d at 42; Esercizio, 944 F2d at 1240. [FN78] To the basic misstatement in Lund II, this adds another, namely, the incorrect view that assessing secondary meaning involves determining whether a product feature is considered primarily a "brand-identifier" or a "useful" article. That confuses secondary meaning with utility, which is akin to confusing secondary meaning with functionality. [FN79] Plainly, a product feature can be both a brand identifier and useful. [FN80] Put another way, the law does not require a party alleging secondary meaning in a claimed trademark to show that its claimed trademark indicates source and, also, that its claimed trademark is not useful.

***604 3. Misreading Samara Brothers**

The district court also misread the Supreme Court's decision in Samara Bros. when it said:

> In a product configuration case, there is a presumption that the product design does not serve as a brand-identifier. Samara Bros., 120 S Ct at 1344. To rebut this presumption, Lund must do more than would be required in a word mark or product packaging case. Specifically, Lund must create an evidentiary basis for inferring that the source-identifying function has subordinated its other functions. [Plaintiff's survey expert] made no attempt to gauge the primary significance of the ... [faucet] design in the minds of retailers by asking a follow-up question as to relative purposes the design serves. It is entirely possible - more, it is presumed - that all respondents associating the ... [[faucet design] with plaintiffs' business also perceive the ... [faucet design] as primarily signaling a useful or attractive faucet. Against this background, [the] survey provides minute evidence of secondary meaning, if any at all. [FN81]
> There is no "presumption" in Samara Brothers of the kind attributed to it by the district court. What the Supreme Court actually said is: because consumers are not predisposed to regard product features as source indicators, a party may not claim that a product feature is inherently distinctive, but must always prove that the feature has acquired distinctiveness (secondary meaning). [FN82] It did not say that a party seeking to prove acquired distinctiveness in a product feature has a heavier burden than a party seeking to prove that other types of non-distinctive words, names, symbols or devices have acquired distinctiveness.

There is no basis in Samara Brothers - or in the law examined in Section II of this article - for requiring a party, as the district court did, to "create an evidentiary basis for inferring the source-identifying function [of a product feature] has *subordinated* its other functions." This non-sequitur confuses acquired distinctiveness (secondary meaning) with functionality. Acquired distinctiveness and functionality are separate issues, not mutually exclusive alternatives. [FN83] A product feature can be (1) distinctive or non-distinctive and, in either case, (2) non-functional or functional. It will be a trademark if it is both distinctive and non-functional. However, there is no requirement that distinctiveness "subordinate"***605** functionality. Put another way, there is no requirement that the feature be distinctive *rather than* functional.

There also is no basis in law for the district court's suggestion that the faucet design may not acquire distinctiveness because it "is entirely possible - more, it is presumed - that all respondents associating the ... [[faucet design] with plaintiffs' business also perceive the ... [faucet design] as primarily signaling a useful or attractive faucet." That statement hopelessly jumbles the concepts of acquired distinctiveness, utility and aesthetic appeal. [FN84] Respondents in a survey can associate the faucet design primarily with plaintiff's faucet and also have views about whether the faucet design is useful or attractive. Indeed, to be a trademark, the feature must be non-functional. If a respondent considers the feature non-functional, he might well find it is not useful. In any case, he might consider it attractive or unattractive. But none of these beliefs precludes him from associating the feature with plaintiff's products.

Finally, none of the district court's misstatements supports its conclusion that "[a]gainst this background, [the] survey provides minute evidence of secondary meaning, if at all." Whether or not the survey established secondary meaning turns solely on the data the survey developed on that issue, not on what respondents may or may not *also* have believed about other issues, namely, whether the faucet design was "attractive" or "useful." Whether or not the public finds a feature "attractive" is irrelevant to whether or not they regard the feature as an indicator of source. [FN85] If a product feature is to be denied trademark protection because it is "useful," the utility must rise to the level of functionality. [FN86] In that event, protection is denied on that basis, not because the feature lacks distinctiveness.

4. Association and Primary Significance

The district court also stated:

> [T]he showing required is *not* merely "that consumers associate the trade dress with a single source." This association***606** test does not equate to the more stringent "primary significance" test first established in Kellogg, and applicable here. The relevant test is that consumers view the trade dress as primarily serving to identify the product's source. See Lund II, 163 F3d at 42. [FN87] That observation runs afoul of a number of the principles discussed in Section II of this article. It fails to appreciate that a claimed trademark acquires distinctiveness when it becomes associated in the public mind with the goods of one, perhaps anonymous, source; that primary significance is a measure of

association, not a separate test for acquired distinctiveness; and that an inquiry concerning association ends the inquiry concerning acquired distinctiveness. [FN88]

5. Ignoring Basic Principles

Because the district court adhered to the Lund II misstatement, misread Lund II and Samara Brothers, regarded association and primary significance as separate tests and found the first test inadequate in a product feature case, it rejected a survey that sought to determine whether respondents associated plaintiff's faucet feature with the products of one, or more than one, company [FN89] and embraced a survey that went beyond this.

The latter survey, approved by the district court, asked the "one company/more than one company" question and then inquired:

> As you look at this faucet, which of the following reasons do you think primarily describes why it looks the way it does? • To tell you who made it or put it out. • To present a pleasing design or appearance or to make the product more useful. ***607** • Primarily for some other reason. [FN90] This approach ignores the definition of a trademark. In referring to "this faucet" and asking about the way "it looks," the question fails to distinguish between the claimed trademark (a non-functional feature of the faucet) and the product (faucet) itself, which the definition of a trademark requires it to do. Accordingly, even if the three options presented by the question could shed light on secondary meaning, [FN91] the survey would fail to address the issue to which it should be directed: has the non-functional feature of the faucet in which a party claims trademark rights acquired secondary meaning?

By way of example, one cannot determine whether the primary purpose of a product feature (the ROLLS-ROYCE grill) is to indicate source or to be pleasing or to be useful by asking those questions about the product (car), rather than the product feature (grill). Because the grill is a non-functional feature of the car (which does not change from year to year) and differs from the car (which does change from year to year), the public might well regard the grill as more likely to indicate the source of the car than they would the car itself. They also may regard the grill as more or less pleasing in appearance than the car. They may perceive the grill to have a different degree of utility from the car.

Even if the survey was directed to the product feature at issue, it would run afoul of a number of other principles discussed in Section II of this article. For one thing, it treats product features differently from other claimed trademarks by insisting on questions that are directed to a product feature's appearance and utility. Further, by rejecting the "one company/more than one company" association approach in favor of three options that explore respondents' primary perceptions about other issues, the survey fails to appreciate that a claimed trademark acquires distinctiveness when it becomes associated in the public mind with the goods of one, perhaps anonymous, source; that primary significance is a measure of this association, not a separate test for acquired distinctiveness; and that an inquiry concerning association of a claimed trademark with goods ends the inquiry concerning acquired distinctiveness.

The survey also confuses acquired distinctiveness with aesthetic appeal and utility by requiring respondents to choose among options that are not mutually exclusive: whether the product tells them who made the product or whether the product is pleasing in appearance or useful. Finally, the survey fails to ***608** reflect that primary significance is an overall measure of the public's primary perception concerning the status of a claimed trademark (association with a single source) and, instead, asks each individual which of three conditions he/she "primarily" perceives to be the case.

The survey also violates the principles discussed in Section III of this article, which follow from those discussed in Section II. Even if the survey was directed to the product feature at issue, the three-options question would not address whether the product feature has acquired secondary meaning. Only the first of the three options concerning "who made" the product even arguably addresses secondary meaning (acquired distinctiveness). Even that option ignores the definition of a trademark, particularly the anonymous source rule, because it could well be understood by respondents to mean that they must be able to name the producer when they see the feature on the product. [FN92] The second option concerns both aesthetic appeal and utility, neither of which is relevant to secondary meaning. [FN93]

The unnecessary confusion engendered by this muddled approach is shown in the survey results. According to the Lund III district court, fifty-five percent of respondents associated plaintiff's product feature with more than one company, and forty-five percent associated it with only one company. [FN94] This, without more, shows that the feature lacked acquired distinctiveness (secondary meaning). [FN95] There was no need to proceed beyond that point. Instead, the court went further and observed that "[o]nly six percent of respondents believed [plaintiff's faucet] came from one company and that the design looks the way it does primarily to 'tell you who made it or put it out."' [FN96]

In the first place, that conclusion is inaccurate. The "one company/more than one company" question appears to have addressed, as it should, the faucet "design" at issue. However, the three-options follow-up question did not because it referred only to the faucet itself. Moreover, ninety-four percent (one hundred percent minus six percent) of the respondents who associated the design with only one company must have chosen the option ***609** regarding aesthetic appeal and utility or the open ended option. [FN97] In doing so, they were focusing on aesthetic appeal or utility or some other reason why the faucet looks the way it does, none of which sheds any light on the issue of secondary meaning. Beyond that, by presenting questions about who makes the product and the product's utility as mutually exclusive alternatives rather than separate inquiries, the survey might falsely suggest that a distinctive product feature is not functional when it actually is. [FN98]

6. Anti-Monopoly Revisited?

The three-options primary significance survey approved by the Lund III district court is disturbingly reminiscent of the Ninth Circuit's misguided approach in Anti-Monopoly, Inc. v. General Mills Fun Group, Inc. [FN99] There, the Ninth Circuit said that the key to primary significance was an inquiry into consumers' primary reason for buying products bearing a claimed trademark, MONOPOLY. [FN100] On remand, the district court rejected a survey by defendant that purported to follow the Ninth Circuit's lead, stating in effect that defendant's survey defied common sense in tying the primary significance of a claimed trademark to the reason behind consumer purchases. [FN101]

However, in a subsequent appeal in Anti-Monopoly, Inc. v. General Mills Fun Group, Inc. [II], [FN102] the Ninth Circuit again found MONOPOLY was generic. In so doing, it embraced the results of defendant's survey, which "sought an explanation of an actual purchaser's motivation in purchasing the game." [FN103] When confronted with evidence that the same survey technique would purportedly demonstrate that the public considers TIDE generic for laundry detergent, the Ninth Circuit responded that: "[if] the general public does think this ... then Procter and Gamble might have cause for alarm." [FN104]

***610** The survey approach embraced by the Lund III district court asks respondents to speculate about the motive of the designer of the product bearing a claimed trademark (product feature), in much the same way as the Anti-Monopoly survey asked respondents about their motive in purchasing products bearing a claimed trademark in an attempt to explore the primary significance of a claimed trademark (MONOPOLY). The Lund III "designer motivation" test is hopelessly removed from the issue of public perception (association of a claimed trademark with goods) that underlies the concept of acquired distinctiveness. What a designer may have intended in designing a feature and what the public has come to believe about the feature's relation to goods are not the same thing. Equating the two concepts contradicts the very notion of secondary meaning, namely, that a product feature - however it started out - may "acquire" distinctiveness as a consequence of how the public comes to perceive it in relation to goods.

A respondent may not attribute to the faucet designer any of the motives - source identification, aesthetical appeal and utility - offered by the Lund III survey question. Conversely, a respondent may believe that the faucet designer intended to create a source indicator that was both attractive and useful. Forcing respondents to choose among these motives, which are not mutually exclusive, sheds no light on acquired distinctiveness. Nor is it any answer that respondents have the option to say that the faucet looks the way it does "primarily for some other reason." What, if any, other reasons the faucet designer had for designing the faucet the way he did has nothing whatever to do with whether the public has come to associate a feature of the faucet with the products of one company to such an extent that the feature can be said to have acquired distinctiveness.

Not unlike the Ninth Circuit's misguided exploration of consumer motivation, the survey approach approved by the Lund III district court fails to assess whether a product feature is or is not distinctive, and it may well falsely suggest that strong product feature trademarks lack distinctiveness. [FN105] Even respondents, who associate the product feature with the products of only one producer, understandably may not say that the primary purpose of the feature is to tell them who makes the product. This occurred in Lund III, where forty-five percent of respondents associated the faucet feature with the faucets of only one producer, but only six ***611** percent of those respondents said the feature [FN106] looks the way it does primarily to tell them who made it. [FN107]

Such disparate answers are hardly surprising. If respondents in such a survey do not know the producer's name, they may say they do not believe that the primary purpose of the feature is to name the producer because the feature did not provide that information. However, such negative answers unfairly prejudice the proponent of the claimed trademark because the claimed trademark's validity does not turn on whether it identifies the producer by name. [FN108] Moreover, whether or not respondents can name the producer, they may say they believe that the primary purpose of the feature is to be pleasing or useful, even though they consider the feature a source indicator. However, because the feature is a valid trademark if it indicates source whether or not respondents find it attractive or useful, forcing upon respondents an artificial choice between source significance and aesthetic appeal or utility is inappropriate. [FN109] Finally, a question that asks why a feature "looks" the way it does is calculated to elicit answers about the appearance of the feature. Under the circumstances, it is small wonder that only six percent of respondents chose the "who made" option when another option mentioned appearance.

These fundamental flaws may be illustrated by the example of the ROLLS-ROYCE grill, which is not only a registered trademark, but no doubt a famous one as well. Many respondents probably would say they associate the grill with the cars of only one company and thus consider it a source indicator (trademark). It is far less clear that the same respondents would also say that the primary purpose of the grill is "to tell them who makes the car." First, given the "byzantine deal under which Volkswagen bought the Rolls [[-Royce] company, but BMW bought the Rolls-Royce name," [FN110] respondents may no longer know, if they ever knew, who makes the car, and the grill - however familiar they may find it - does not provide them with that information. Second, common sense alone suggests that many respondents would entertain all three notions, regarding the grill as a source indicator, attractive and useful. Many or perhaps even most ***612** respondents, if forced to choose, might say that the grill looks the way it does primarily because the company wanted an attractive or useful grill, not because the company wanted the grill to indicate source. But the validity of the grill trademark does not turn upon the order in which respondents rank those beliefs when forced to choose between them. Finally, it would be foolish to conclude that the grill is not a valid trademark because many, or even most, people find it attractive or useful.

Ironically, while distorting the law, the Lund III survey ultimately fails to address a chief concern voiced by the Lund III district court. According to the district court, a drawback of the "one company/more than one company" survey approach is that it does not ask respondents to identify the one company they have in mind. [FN111] However, the Lund III survey approved by the district court does not do that either. It asks only whether the product feature "tell [[s] you who made [the product]." It does not ask respondents to identify the maker of the product they have in mind.

B. The Real Problems with the Lund III Survey: Timing and Anonymous Source

The chief evidentiary problems with the Lund III surveys regarding whether plaintiff's faucet design had acquired secondary meaning stem from the fact that: (1) the surveys were conducted years after defendant had introduced its faucet, and (2) during that time, a number of consumers apparently had come to associate the faucet design with defendant (and perhaps other companies as well).

1. The Problem of Timing

As discussed in Surveying Secondary Meaning, a troublesome issue is how a survey can determine whether or not a claimed trademark possessed secondary meaning at the time defendant entered the market place, if the survey is conducted after plaintiff brought an action arising out of defendant's allegedly infringing activity. [FN112] Surveying Secondary Meaning suggested that one approach would be to admit such a post-infringement survey and evaluate its probative value in light of conditions prevailing in the market place at the time the survey was conducted. If those conditions suggest that the association of plaintiff's claimed trademark with its goods is not significantly stronger than it was ***613** when defendant entered the market place, the survey should be given more weight than if conditions suggested the opposite.

Considering defendant's criticism of a secondary meaning survey, the court in STX, Inc. v. Trik Stik, Inc. [FN113] essentially adopted this common sense approach and placed the burden on defendant to challenge the probative value of plaintiff's survey:

> Defendant asserts only that the study does not measure public association at the time defendant began marketing Dr. Bone Savers .... [D]efendant has not provided any evidence that suggests that this study does not validly reflect the associations eight months before it was conducted. Plaintiff's product had been on the market for nine years and had generated substantial market identity prior to the introduction of defendant's product. It is unrealistic to expect a plaintiff to generate market studies until a potential infringer is discovered. [FN114] Faced with this timing issue, the Lund III district court acknowledged that plaintiff might have had a better chance of establishing secondary meaning if it had conducted its surveys earlier, but decided to place "the consequences of the failure to do so at Lund's feet because Lund carries the burden of proof." [FN115]

Whatever merit this approach may have had in Lund III, [FN116] as a general proposition it sets out a harsh rule that will often harm, and may even doom, a plaintiff's case. No plaintiff can reasonably be expected to conduct a secondary meaning survey for litigation purposes until the occasion for litigation arises. It is not realistic to expect a trademark owner to spend thousands of dollars on a survey it may never need. Moreover, if a trademark owner did conduct a survey before the survey was needed, a defendant might argue that the survey was done too far in advance of litigation, has grown stale and, thus, does not reflect the status of plaintiff's claimed trademark when defendant entered the market.

On the other hand, when the occasion for litigation does arise, defendant will necessarily already have made sales of its product bearing the allegedly infringing mark. Particularly if defendant's mark closely resembles plaintiff's mark, defendant's sales will reduce the chances that a survey can show that the public associates the mark with the products of only one source (plaintiff) because some members of the public will have come to associate it ***614** with products from another source (defendant). Put another way, defendants' very act of infringement (if that is what it is) will interfere with, if not defeat, plaintiff's attempt to enforce its rights. And the more closely defendant's mark resembles plaintiff's mark, the harder it will be for plaintiff to make its case, because the public will be more likely to associate the mark with the products of both plaintiff and defendant, not with the products of plaintiff alone.

2. The Problem of Anonymous Source

As discussed in Surveying Secondary Meaning, asking if respondents associate a claimed trademark with the products of one or more than one company may leave defendant wondering whether or not the single unidentified company whose product consumers have in mind, in fact, is the plaintiff. Thus, defendant may prefer two related questions:

> Do you associate [claimed trademark] with [product identification] of one, or more than one, company? If [product identification] of one company, which company? [FN117] Faced with this issue, the Lund III district court refused to credit a survey that allegedly established association of plaintiff's faucet design with the products of one company [FN118] because the survey did not ask respondents to identify the company by name [FN119] and a different survey suggested that some respondents attributed the faucet design to defendant or third parties. [FN120] One problem with the court's approach is that it adds a burden to plaintiff's case that plaintiff should not have to shoulder in view of the anonymous source rule. [FN121] Under that rule, plaintiff should not be required to show that survey respondents can identify plaintiff by name as the single source of the products with which they associate the claimed trademark.

3. Addressing the Problems

The two problems discussed above should encourage plaintiffs to move quickly against defendants that they believe are infringing their rights and to conduct promptly any secondary meaning surveys that may be needed to make out their case. The problems ***615** of timing and anonymous source do not, however, justify rejecting the "one company/more than one company" survey approach in favor of some other approach that runs afoul of basic principles.

In evaluating the "one company/more than one company" survey approach in light of the anonymous source rule, a court might properly consider how promptly plaintiff has proceeded. For example, if plaintiff proceeds promptly, and some consumers nevertheless associate the claimed trademark with defendant's products and no one associates the claimed trademark with the products of any other party, it may be more reasonable to discount the association with defendant's products than it would be if plaintiff sleeps on its rights and permits its claimed trademark to become firmly associated with defendant's products and the products of third parties as well as its own.

A court also might consider assigning to defendant the burden of establishing that the single anonymous source disclosed by plaintiff's survey, in fact, is not the plaintiff. Under this approach, plaintiff could make out its case by showing in a "one company/more than one company" survey that its claimed trademark has become associated with the products of a single anonymous source by a majority of respondents. If defendant questions the identity of the products' source, it can shoulder the burden of proving that respondents did not have in mind plaintiff's products by conducting its own survey and asking both the "one company/more than one company" question and a follow-up question concerning the identity of the company whose products respondents have in mind. This would allow plaintiff to claim the benefit of the anonymous source rule to which it is entitled; would protect defendant from an unfair result in cases where plaintiff's products are not the products that a majority of respondents have in mind; and discourage frivolous challenges by defendants, who might otherwise be heard to object that any survey is worthless if it adheres to the anonymous source rule. [FN122]

Moreover, if a "one company/more than one company" survey requires respondents to identify by name the source of products in a follow-up question, a court should pause before discarding survey results that name only plaintiff and defendant, particularly if there is other circumstantial evidence to suggest that the public associates the claimed trademark with plaintiff's products. Although such a survey arguably shows that the claimed trademark is not associated with the products of a single source ***616** (plaintiff) by a majority of respondents, a court that rejects it too readily may unwittingly be encouraging second comers to infringe. The situation arguably differs from one in which the same type of survey shows that a majority of the public associates the claimed trademark with the products of more than one source apart from plaintiff, namely, the products of defendant and one or more third parties.

In view of the foregoing, one of plaintiff's two surveys in Lund III seems ill-conceived. According to the Lund III district court, when respondents were shown plaintiff's faucet (among others) and were asked who made it, twenty percent said plaintiff, eighteen percent said defendant, ten percent said some other manufacturer and thirteen percent said one source they could not name. [FN123] Somewhat remarkably, plaintiff argued that this established secondary meaning because it showed that a majority of respondents (sixty-one percent) believed that the faucet originated with one source. [FN124] However, the survey does not take into account the distinction between a product feature (claimed trademark) and the product itself, which is inherent in the definition of a trademark. Moreover, by asking respondents to name the source of the faucet in the first instance, the question ignored the anonymous source rule. Finally, having unnecessarily taken on this added burden, plaintiff inexplicably relied on answers which showed that relatively few respondents (twenty percent) believed the faucet came from plaintiff and that a majority of respondents (sixty-one percent) identified a number of different companies as the product's source.

4. Numbers Out of Context

Much ink has been spilled debating what percentage of survey respondents must regard a word, name, symbol or device as a trademark before it will be considered to have acquired secondary meaning. [FN125] The problem with a lot of this is that it takes no account of survey technique.

Whatever the issue, survey technique can affect response rate. This is illustrated by the confusion surveys in Union Carbide Corp. v. Ever-Ready Inc., [FN126] where one technique showed that 0.6 percent of respondents in a survey were confused by defendant's use of EVER-READY for lamps, whereas another technique ***617** showed a 54.6 percent confusion rate. A number of different survey techniques have been used to try to assess secondary meaning. [FN127] For example, some courts have credited brand awareness studies as evidence of secondary meaning, [FN128] and some of these studies have shown response rates as high as ninety-six percent. [FN129]

It is inappropriate to transpose numbers from these secondary meaning surveys to a "one company/more than one company" secondary meaning survey, which determines primary significance (association) from the answers to two, and only two, mutually exclusive questions. In a "one company/more than one company" survey, only a "one company" response over fifty percent can be considered evidence of secondary meaning. [FN130] By way of example, where "X" is the claimed trademark and the competing products of several producers are circles, "X" will be a trademark where more people associate it with only one producer's products than associate it with the products of several producers:

It is inappropriate to infer secondary meaning from a "one company/more than one company" survey that shows "significant or substantial" association of the claimed trademark with the goods of only one company if that association is less than fifty percent. That is because more than fifty percent of respondents necessarily regarded the claimed trademark as something other than a valid trademark because they associated it with the goods of more than one company. If one departs from this majority rule, it should be to accommodate guessing [FN131] or "no company" responses,***618** [FN132] but not because cases involving other survey techniques have reported other numbers. [FN133]

In Lund III, one of the plaintiff's surveys ignored this rule. Although the survey employed a "one company/more than one company" approach, the plaintiff argued that the survey established secondary meaning because it showed that "'a significant or substantial"' portion of respondents associated the claimed trademark with only one company. [FN134] Among one group of respondents, single source association was apparently 62.7 percent (which indicates secondary meaning assuming the survey was otherwise sound). [FN135] However, among a different group of respondents, single source association was apparently only 42.3 percent (which does not indicate secondary meaning because 57.7 percent must have associated the claimed trademark with the goods of more than one company). [FN136]

V. BEYOND PRIMARY SIGNIFICANCE

Whether one regards primary significance as a measure of association or a separate test, an underlying assumption is that the public faces a choice between two, and only two, mutually exclusive alternatives and, thus, "majority usage" controls. [FN137] In ***619** fact, the issue may not be that simple because, for example, words may have a dual significance. [FN138]

Similarly, as a measure of association, primary significance assumes that the public either associates a word, name, symbol or device with the goods of one company or associates it with the goods of more than one company. In fact, some members of the public may not associate the word, name, symbol or device with the goods of any company. This could occur if a person is not familiar with the type of goods at issue. It also could occur if a person is familiar with such goods, but does not associate the word, name, symbol or device with such goods.

The last prospect may initially appear unlikely where words are involved. Once producers begin to market a product (e.g., "bottled water"), one assumes that people will say that they either: (1) associate a term (e.g., "clear") with the products of several companies (because the term describes all those products) or (2) associate the term with the products of only one company, in which case the term would be a trademark (e.g., "CLEAR brand bottled water"). In practice, however, although the word "clear" no doubt describes bottled water, some people may not actually associate the term with any company's bottled water because they have not encountered the use of the term (descriptively or as a trademark) by bottled water companies operating in the market place. The phenomenon is perhaps easier to appreciate where a design, rather than a word, is involved. A decorative feature such as a star design (that is not entitled to protection absent acquired distinctiveness) may not be associated by some people with the products (lamps) of any company because those people have not seen it used by any lamp company (and the feature has no descriptive meaning that would suggest it ought to be associated with lamps from several companies).

To accommodate this phenomenon, one must depart from the mutually exclusive binary choice that underlies primary significance and recognize four possible associations between a word, name, symbol or device and goods, namely, association of the claimed trademark with:

> (1) the products of only one company; (2) the products of more than one company; (3) no company's products, because the respondent is familiar with the type of products, but does not associate the word, name, symbol or device with any company's products; or ***620** (4) no company's products, because the respondent is not familiar with the type of products. The fourth category of respondents can be eliminated from a secondary meaning survey by an initial screening question, designed to weed out respondents who are not purchasers or potential purchasers of the type of product at issue (and whose views should not be solicited in any event).

Eliminating this category would result in a survey that asked a relevant universe of respondents:

Do you associate [claimed trademark] with the [product identification] of:

• one company • more than one company • no company. By way of example, where "X" is the claimed trademark and the competing products of several producers are circles, members of the public might associate the claimed trademark with the products of:

Where respondents give one of three, rather than two, mutually exclusive responses, the "primary" response is not necessarily the response given by a majority of all respondents. For example, a survey might show:

C1Answer........	Percentage
One company........	45
More than one company........	35
No company........	20

***621** The question remains: how do the answers to these three questions need to turn out for one to conclude that a word, name, symbol or device has acquired distinctiveness sufficient to confer on it the status of a trademark? An argument can be made that "no company" responses should be eliminated because they indicate that respondents: (1) consider a word or name neither a trademark for one party's goods nor descriptive of that type of goods or (2) consider a symbol or device neither a trademark for one party's goods nor a decorative feature that any producer of the goods could be expected to use. In either case, trademark status would turn on the answers given by the majority of the remaining respondents. In the above example, the majority (primary) response (45 of 80) would be "one company," and the primary significance of the claimed trademark would thus be that of a source indicator (trademark). Alternatively, one could urge that exclusive rights in a word, name, symbol or device should not be conferred upon one party until single source association is the primary view of all respondents. In the above example, the majority (primary) response (55 of 100) would not be "one company," and the primary significance of the claimed trademark would thus not be that of a source indicator.

VI. CONCLUSION

Basic principles suggest that the Lund decisions contain serious errors, which if perpetuated will distort the law and mislead parties litigating trademark cases involving secondary meaning. That the Lund surveys may have been in some respects genuinely flawed, or the data inadequate to establish secondary meaning when even sound principles were applied, does not excuse the plain errors that the courts made in Lund II and Lund III. The decisions should be reconsidered, bearing in mind not only the principles enunciated in this article but also a more basic notion: a survey is simply one form of evidence that ought to be evaluated along with other credible evidence that bears on the issue to which the survey is addressed.

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[FN1]. I.P. Lund Trading ApS v. Kohler Co., 11 F Supp2d 112 (D Mass 1998) ("Lund I"), motion for a stay of the injunction pending appeal denied I.P. Lund Trading ApS v. Kohler Co., 11 F Supp2d 127 (D Mass 1998); I.P. Lund Trading ApS v. Kohler Co., 163 F3d 27, 49 USPQ2d 1225 (CA 1 1998) ("Lund II"); I.P. Lund Trading ApS v. Kohler Co., 118 F Supp2d 92, 56 USPQ2d 1776 (D Mass 2000) ("Lund III").

[FN2]. See generally Vincent N. Palladino, Genericness and The Trademark Clarification Act of 1984: Five Years Later, 79 TMR 657 (1989), discussing the Ninth Circuit's decision in Anti-Monopoly, Inc. v. General Mills Fun Group, Inc., 684 F2d 1316, 216 USPQ 588 (CA 9 1982), and subsequent amendment of the Lanham Act, Pub L No 98-620, 98 Stat 3335 (1984).

[FN3]. This article refers throughout to secondary meaning in "trademarks" including non-functional product features. Certain trademarks, including particularly those that are "symbols" or "devices," can also be referred to as "trade dress." See Wal-Mart

Stores, Inc. v. Samara Brothers, Inc., 529 US 205, 209, 54 USPQ2d 1065, 1067 (2000) ("'trade dress'-a category that originally included only the packaging, or 'dressing,' of a product, ... in recent years has been expanded ... to encompass the design of a product .... [[T]rade dress constitutes a 'symbol' or 'device' for purposes of the relevant sections" of the Lanham Act.).

[FN4]. 15 USC § 1127 (Supp 2000). See also United Drug Co. v. Rectanus Co., 248 US 90, 97 (1918); McLean v. Fleming, 96 US 245, 254 (1878).

[FN5]. Qualitex Co. v. Jacobson Products Co., Inc., 514 US 159, 163, 34 USPQ2d 1161, 1163 (1995) (emphasis added) ("to identify and distinguish the goods - i.e., 'to indicate' their 'source'"; "identifies and distinguishes a particular brand (and *thus* indicates its 'source')").

[FN6]. A word or name is incapable of being a trademark if it is generic. 2 J. Thomas McCarthy, McCarthy on Trademarks and Unfair Competition, § 12:1 at 12-3 to 12-4 (4th ed 2000) ("a generic name ... can never function as a trademark to indicate origin"). A symbol or device is incapable of being a trademark if it is functional. 1 McCarthy, id, § 7:64 at 7-142.

[FN7]. Qualitex, supra note 5 at 163, 34 USPQ2d at 1162-63 (certain authorities omitted). Accord Restatement Third of the Law of Unfair Competition § 13 (ALI 1995) [hereinafter referred to as Restatement Third] (a designation acquires secondary meaning when it "has become distinctive, in that, as a result of its use, prospective purchasers have come to perceive it as a designation that identifies goods" in a certain way, namely, as goods "produced or sponsored by a particular person, whether known or anonymous").

[FN8]. Restatement Third, id § 13, Comment e at 108 (association "as a result of its use by a specific person"). See also Qualitex, supra note 5, ibid.

[FN9]. See supra note 7.

[FN10]. 505 US 763, 766 fn 4, 23 USPQ2d 1081, 1082 (1992) (emphasis added).

[FN11]. 456 US 844, 851 fn 11, 214 USPQ 1, 4 (1982) (emphasis added).

[FN12]. 305 US 111, 120, 39 USPQ 296, 300 (1938) (emphasis added).

[FN13]. Supra note 7, § 13, Comment e at 108.

[FN14]. For example, the ROLLS-ROYCE grill differs from the car itself and from all other cars with grills, just as a star-shaped base differs from a lamp in which it is incorporated and from all lamps that lack that design. Moreover, both the feature and the product differ from the car company or the lamp maker that produces the product with the feature and from others who also make cars or lamps. This is true of even simple products with basic designs. For example, there is a difference among the design of a paperweight in the shape of a cube, the paperweight itself and the company that makes the paperweight. The design is a cube shape. The product is a paperweight. If only one company makes cube-shaped paperweights long enough, the shape could become associated with the paperweights of only one company.

[FN15]. Supra note 3.

[FN16]. Id at 212-13, 54 USPQ2d at 1068-69.

[FN17]. Id at 211, 54 USPQ2d at 1068. In a footnote, the Wal-Mart Court characterized "secondary meaning" as a misnomer when applied to all non-word marks, not just product features, because non-word marks do not have a primary meaning in the language. Id at 211 fn *, 54 USPQ2d at 1068. That is not a distinction between product features and all other marks with respect to secondary meaning. On the contrary, the Court simply concluded that clarity might be served by substituting "acquired meaning" for secondary meaning" in *all* cases. Probably, clarity would be best served by using "acquired distinctiveness" because "distinctiveness," not "meaning," is the issue.

[FN18]. See supra note 11.

[FN19]. See supra note 12.

[FN20]. Ibid.

[FN21]. Levi Strauss & Co. v. Blue Bell, Inc., 632 F2d 817, 820, 208 USPQ 713, 716 (CA 9 1980) (emphasis omitted) (quoting Carter-Wallace, Inc. v. Procter & Gamble Company, 434 F2d 794, 802, 167 USPQ 713, 719 (CA 9 1970)). See, eg, Co-Rect Products, Inc. v. Marvy! Advertising Photography Inc., 780 F2d 1324, 1330, 228 USPQ 429 (CA 8 1985); RJR Foods, Inc. v. White Rock Corp., 603 F2d 1058, 203 USPQ 401 (CA 2 1979); American Heritage Life Insurance Co. v. Heritage Life Insurance Co., 494 F2d 3, 12, 182 USPQ 77, 83 (CA

5 1974).

[FN22]. RJR Foods, id at 1059, 203 USPQ at 402. See other cases cited at supra note 21.

[FN23]. Two Pesos, supra note 10 at 766 fn 4, 23 USPQ2d at 1084.

[FN24]. Supra note 7, § 13, Comment e at 108.

[FN25]. See, eg, Centaur Communications Ltd. v. A/S/M Communications Inc., 830 F2d 1217, 1221 fn 11, 4 USPQ2d 1541, 1544 (CA 2 1987); Ciba-Geigy Corp. v. Bolar Pharmaceutical Co. Inc., 547 F Supp 1095, 1113, 215 USPQ 769, 783-84 (D NJ 1982), affd 719 F2d 56 (CA 3 1983) (citing Processed Plastic Co. v. Warner Communications, Inc., 675 F2d 852, 856, 216 USPQ 1072, 1074 (CA 7 1982)), and Family Circle, Inc. v. Family Circle Associates, Inc., 332 F2d 534, 141 USPQ 848, 852 (CA 3 1964).

[FN26]. 15 USC § 1127 (Supp 2000).

[FN27]. Restatement Third, supra note 7, § 13.

[FN28]. Supra note 10.

[FN29]. Kellogg, supra note 12 at 117, 39 USPQ at 299.

[FN30]. Id at 116, 39 USPQ at 298 (emphasis added).

[FN31]. Id at 120, 39 USPQ at 300 (emphasis added).

[FN32]. See supra notes 29-31.

[FN33]. Kellogg, supra note 12 at 118, 39 USPQ at 299 (emphasis added).

[FN34]. Ibid.

[FN35]. Restatement Third, supra note 7, § 13.

[FN36]. Id § 15.

[FN37]. Id at 153-54 (emphasis added).

[FN38]. 2 McCarthy, supra note 6, § 12:6 at 12-14 to 12-15 (citations omitted; original emphasis).

[FN39]. Concerning this possibility, see 5 McCarthy, id, § 32:190 at 32-316. ("There would seem to be no logical reason to require any higher percentage to prove secondary meaning than to prove a likelihood of confusion. There is a close relationship between the two doctrines. If the survey results are so strong and conclusive as to establish actual confusion, then some courts view the results as also being evidence of secondary meaning. But the rebuttal to this argument is that secondary meaning is an issue of validity, more akin to the majority usage test of genericness than to the significant number test of infringement.").

[FN40]. See America Online v. AT&T Corp., 243 F3d 812, 821-22, 57 USPQ2d 1902, 1910 (CA 4 2001) (discussing AOL's argument that a "one company/more than one company" secondary meaning survey provided evidence from which a jury could conclude that the "primary significance to the relevant public of the phrase 'You Have Mail' is to denote its source and therefore that the term is not generic."). Such public association would occur if others actually use the word, name, symbol or device. Moreover, it could also occur even if others do not use it, provided the word, name, symbol or device is perceived as a descriptive word or name or decorative symbol or device that others could be expected to use in connection with their goods. For a discussion of this possibility, see infra Section V.

[FN41]. Kellogg, supra note 12 at 118, 39 USPQ at 299.

[FN42]. Two Pesos, supra note 10 at 766 fn 4, 23 USPQ2d at 1082, citing Inwood Laboratories, supra note 11.

[FN43]. See Vincent N. Palladino, Surveying Secondary Meaning, 84 TMR 155, 178 (1994).

[FN44]. Qualitex, supra note 5 at 163, 34 USPQ2d at 1162-63 (certain authorities omitted).

[FN45]. See supra note 2.

[FN46]. See especially supra note 38.

[FN47]. See, eg, 1 McCarthy, supra note 6, § 7:24 at 7-62 ("The 'merely ornamental' objection is ... merely a specialized application of the general enquiry as to whether a given design is or is not perceived by customers as a symbol of origin .... If customers perceive a design as not only attractive, but as an indicator of source, then it is a trademark.").

[FN48]. See discussion at infra Section II.I.

[FN49]. See, eg, 1 McCarthy, supra note 6, § 7:24 at 7-62.

[FN50]. See supra note 47.

[FN51]. 1 McCarthy, supra note 6, § 7:24 at 7-62 ("If customers perceive [an attractive] design ... as an indicator of source, then it is a trademark. The issue is not one of public policy against 'aesthetic functionality ....'").

[FN52]. See supra note 47.

[FN53]. Restatement Third, supra note 7, § 17, Comment c at 175-76 (emphasis added).

[FN54]. See, eg, TrafFix Devices, Inc. v. Marketing Displays, Inc., 532 US 23, 121 S Ct 1255, 149 L Ed2d 164, 58 USPQ2d 1001 (2001); Restatement Third, id § 16, which makes plain that the design of a product is eligible for protection as trademark if "(a) the design is distinctive under the rule stated in § 13 [which includes secondary meaning]; and (b) the design is not functional under the rule stated in § 17."

[FN55]. 1 McCarthy, supra note 6, § 7:66 at 7-149 to 7-150.

[FN56]. See generally 1 McCarthy, id, § 7:80 at 7-192 ("the majority of courts have rejected the theory of aesthetic functionality").

[FN57]. Keene Corp. v. Paraplex Industries, Inc., 653 F2d 822, 827, 211 USPQ 201, 205 (CA 3 1981) (citations omitted).

[FN58]. 560 F Supp 85, 217 USPQ 252 (SD Iowa 1982), affd 721 F2d 253 (CA 8 1983).

[FN59]. Id at 98, 217 USPQ at 262.

[FN60]. Ibid.

[FN61]. Id at 99, 217 USPQ at 262-63.

[FN62]. Supra note 43.

[FN63]. Id at 162-63.

[FN64]. Id at 165.

[FN65]. Id at 178.

[FN66]. See supra note 47.

[FN67]. See supra note 53.

[FN68]. This question is offered by way of illustration without suggesting that it would necessarily be appropriate in an aesthetic functionality survey. Designing a survey of aesthetic functionality, which must take account of the meaning of that concept, is outside the scope of this article.

[FN69]. Other answers might suggest that the feature is not aesthetically functional. For example, a respondent who regards the feature as a non-functional trademark might answer that he is less likely to buy the product without the feature because he prefers the products of the trademark owner, eg, "I prefer John Deere" (and "I would regard a loader that is not painted John Deere green as somebody else's product").

[FN70]. Lund II, supra note 1 at 42, 49 USPQ2d at 1235.

[FN71]. Ibid.

[FN72]. See supra note 47.

[FN73]. Lund III, supra note 1 at 104, 56 USPQ2d at 1786-87 (footnote omitted).

[FN74]. See supra notes 4, 5 and 28-44.

[FN75]. See supra note 71.

[FN76]. Lund III, supra note 1 at 107-08, 56 USPQ2d at 1789.

[FN77]. See supra note 47 and Section III.D.

[FN78]. Lund III, supra note 1 at 109, 56 USPQ2d at 1791.

[FN79]. See supra notes 54-61. Even as a misguided attempt to take account of competitive needs, the focus on "utility" is misplaced because "utility" is not necessarily "functionality." See supra note 53. Moreover, neither Lund II nor Esercizio v. Roberts, 944 F2d 1235, 20 USPQ2d 1001 (CA 6 1991), supports the district court's reference to a "useful" article. Nor does Esercizio support a choice between secondary meaning and aesthetical appeal, as Lund III suggests. Esercizio simply says that product features "would not acquire secondary meaning merely because they are ... aesthetically beautiful." 944 F2d at 1240, 20 USPQ2d at 1006. That is plainly so. See supra note 47. However, that is very different from saying, as Lund III does, that the product feature must (1) have acquired secondary meaning and (2) "not [be] ... aesthetically pleasing." An aesthetically pleasing product feature can acquire secondary meaning.

[FN80]. This would occur if the feature has acquired distinctiveness and is useful, but not functional. This follows from the fact that (1) a product feature is a trademark if it is both distinctive and non-functional and (2) a utilitarian feature is non-functional if the utility does not rise to the level of functionality. See supra notes 53 and 54.

[FN81]. Lund III, supra note 1 at 108, 56 USPQ2d at 1789.

[FN82]. Wal-Mart, supra note 3 at 213, 54 USPQ2d at 1068.

[FN83]. See supra notes 54-61.

[FN84]. See supra notes 49-61. Wal-Mart, supra note 3 at 213, 54 USPQ2d at 1069, is not to the contrary. In discussing the inherent distinctiveness of product features, the Court said only that consumers are not predisposed to regard such features as source indicators and recognized that most such features are not "intended ... to identify the source, but to render the product itself more useful or more appealing." That says nothing about acquired, as opposed to inherent, distinctiveness. It simply recognizes the reality that the public is likely to believe that a product designer or manufacturer probably set out to create a useful or appealing feature. It does not address the separate question of whether the public has come to regard that useful or appealing feature as an indicator of source.

[FN85]. See supra note 47.

[FN86]. See supra note 53.

[FN87]. Lund III, supra note 1 at 110 fn 31, 56 USPQ2d at 1791 (emphasis in original).

[FN88]. Equally misplaced is the court's reliance on Vornado Air Circulation Systems v. Duracraft, 58 F3d 1498, 1502 fn 7, 35 USPQ2d 1332, 1334 (CA 10 1995) (several citations omitted). The Vornado Court said in dicta that:

> Some of our previous cases may have led Vornado to believe that mere association is sufficient [to show secondary meaning]. But the Supreme Court has made clear that the test is the more stringent "primary significance" standard. See Kellogg Co. v. National Biscuit Co., 305 U.S. 111, 118, 59 S.Ct. 109, 113, 83 L.Ed. 73 (1938). For other cases also citing the "primary significance" test, see Qualitex Co. v. Jacobson Prods. Co., 514 U.S. 159, ___, 115 S.Ct. 1300, 1303, 131 L.Ed.2d 248 (1995); Two Pesos, Inc. v. Taco Cabana, Inc., 505 US 763 ___ n. 4, 112 S.Ct. 2753, 2756 n. 4, 120 L.Ed.2d 615 (1992); Inwood Labs., Inc. v. Ives Labs., Inc. 456 US 844, 851 n. 11, 102 S.Ct. 2182, 2187 n. 11, 72 L.Ed.2d 606 (1982).

That misreads those Supreme Court cases for the reasons discussed in Section II of this article. See supra notes 19-23, 28-34.

[FN89]. Lund III, supra note 1 at 108-10, 56 USPQ2d at 1789-91.

[FN90]. Id at 110-11, 56 USPQ2d at 1792.

[FN91]. For a discussion of why they do not do this, see the text at infra notes 92-93.

[FN92]. Moreover, coming as it does after "the one company/more than one company" acquired distinctiveness (secondary meaning) question, the "who made" option is redundant to the extent it also explores distinctiveness and is thus confusing.

[FN93]. Moreover, by combining two different concepts (aesthetic appeal and utility) in one option, it violates a basic principle of good survey design.

[FN94]. Lund III, supra note 1 at 111, 56 USPQ2d at 1792.

[FN95]. See supra note 65.

[FN96]. Lund III, supra note 1 at 111, 56 USPQ2d at 1792.

[FN97]. See supra note 90.

[FN98]. Although utility and functionality are not equivalent, an uninformed court could confuse the two concepts and believe that the survey establishes both acquired distinctiveness and non-functionality (non-utility) if respondents chose option one over option two. However, because acquired distinctiveness and functionality are separate issues, not mutually exclusive alternatives, the survey would actually have failed to examine whether the public considers the feature functional.

[FN99]. 611 F2d 296, 204 USPQ 978 (CA 9 1979).

[FN100]. Id at 305-06, 204 USPQ at 986.

[FN101]. Anti-Monopoly, Inc. v. General Mills Fun Group, Inc., 515 F Supp 448, 453-54, 212 USPQ 748, 751-53 (ND Calif 1981).

[FN102]. 684 F2d 1316, 216 USPQ 588 (CA 9 1982). See also supra note 2.

[FN103]. Id at 1325, 216 USPQ at 595.

[FN104]. Id at 1326, 213 USPQ at 596.

[FN105]. The following discussion assumes that the question is directed to the product feature. In fact, the question in the Lund III survey was directed to the product, not the feature, which is an additional flaw in the survey.

[FN106]. In fact, the 6 percent were addressing a question about the faucet, not the feature. See supra note 105. This may help to explain the disparity between 45 percent and 6 percent. Some respondents who associated the *feature* with one company, may not have believed the *faucet* looks the way it does to identify source.

[FN107]. See supra notes 94 and 96.

[FN108]. See supra notes 4-5.

[FN109]. See supra Section III.D.

[FN110]. Automobiles, The New York Times, January 28, 2001.

[FN111]. Lund III, supra note 1 at 106, 110, 56 USPQ2d at 1788, 1791.

[FN112]. Palladino, Surveying Secondary Meaning, supra note 43 at 158-59.

[FN113]. 708 F Supp 1551 (ND Calif 1988).

[FN114]. Id at 1559.

[FN115]. Lund III, supra note 1 at 105 fn 19, 56 USPQ2d at 1787.

[FN116]. Lund III indicates that plaintiff conducted its secondary meaning surveys about its faucet in 1999, three years after defendant began to sell its faucet.

[FN117]. See Palladino, Surveying Secondary Meaning, supra note 43 at 168-69.

[FN118]. Lund III, supra note 1 at 110, 56 USPQ2d at 1791.

[FN119]. Ibid.

[FN120]. Id at 106, 56 USPQ2d at 1788.

[FN121]. See generally Palladino, Surveying Secondary Meaning, supra note 43 at 169.

[FN122]. Because it is notoriously easy to criticize a survey, courts may discount criticisms by a party if the party has not conducted its own survey. See, eg, Tyco Industries Inc. v. Lego Systems, Inc., 5 USPQ2d 1023 (D NJ 1987), affd without published opinion 853 F2d 921 (CA 3 1988).

[FN123]. Lund III, supra note 1 at 106, 56 USPQ2d at 1788.

[FN124]. Id at 107, 56 USPQ2d at 1788.

[FN125]. See, eg, cases discussed at Palladino, Surveying Secondary Meaning, supra note 43 at 180-81.

[FN126]. 531 F2d 366, 188 USPQ 623 (CA 7 1976).

[FN127]. See Palladino, Surveying Secondary Meaning, supra note 43 at 172-77.

[FN128]. Id at 176-77.

[FN129]. Id at 177.

[FN130]. Id at 178. See supra notes 64-65.

[FN131]. Id at 179-80.

[FN132]. See infra Section V.

[FN133]. The situation is even more problematic when surveys designed to explore other issues, such as likely confusion, are used to assess secondary meaning. There no doubt is a link between secondary meaning and confusion. See supra note 39. However, a confusion survey may not be a reliable guide to the existence or non-existence of secondary meaning. Although respondents cannot be confused by a junior user's mark unless they already associate the same or a similar mark with a senior user, the failure of a survey to show confusion may not be evidence that the senior user's mark lacks distinctiveness. For example, it would be a mistake to conclude that EVEREADY is not a distinctive mark for batteries because a confusion survey showed only 0.6 percent confusion of EVER-READY lamps with EVEREADY batteries. See generally Palladino, Surveying Secondary Meaning, supra note 43 at 181-85.

[FN134]. Lund III, supra note 1 at 1790.

[FN135]. As the Lund III court observed, plaintiff's decision to survey only those familiar with the claimed trademark may have been problematic. But see Palladino, Surveying Secondary Meaning, supra note 43 at 179-80. Familiarity with a claimed trademark may not necessarily be a bias where the issue is how respondents perceive a claimed trademark with which they are familiar. For example, respondents may be familiar with a word ("clear"). However, that familiarity need not bias their answers to a question that seeks to determine whether they associate the word with products of one or more than one company, i.e., whether they consider the word a trademark ("CLEAR water") or a descriptive term ("clear water").

[FN136]. See also America Online, supra note 40 at 821, 57 USPQ2d at 1910, in which plaintiff argued that a forty-one percent response rate in a "one company/more than one company" secondary meaning survey established secondary meaning.

[FN137]. See supra notes 37-38.

[FN138]. See generally Jerre B. Swann and Vincent N. Palladino, Surveying "Genericness": A Critique of Folsom and Teply, 78 TMR 179 (1988).

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APPENDIX 2

H

***1** THIS OPINION IS NOT A PRECEDENT OF THE T.T.A.B.

Trademark Trial and Appeal Board

Patent and Trademark Office (P.T.O.)
KING RANCH IP, LLC [FN1]
v.
GWB, INC.
CANCELLATION 92032301
April 13, 2007
Hearing: July 18, 2006

Paul C. Van Slyke of Locke Liddell & Sapp LLP for King Ranch IP, LLC

James E. Shlesinger of Shlesinger, Arkwright & Garvey LLP

Before Rogers, Holtzman and Walsh

Administrative Trademark Judges

Opinion by Walsh

Administrative Trademark Judge:

On July 31, 2001, King Ranch IP, LLC (petitioner) petitioned to cancel a registration owned by GWB, Inc. (respondent), namely, Reg. No. 2422044 for the mark RANCH KING for goods identified as "headwear" in International Class 25. The application for this registration was filed on February 1, 1999; the registration issued on January 16, 2001; and it is active. The registration specifies a date of first use anywhere and first use in commerce on June 1, 1999.

As grounds for cancellation petitioner asserts a likelihood of confusion under Trademark Act Section 2(d), 15 U.S.C. § 1052(d), between respondent's RANCH KING mark and petitioner's KING RANCH mark for various goods and services. Petitioner asserts that it used its KING RANCH mark on a variety of goods and services, including hats and other types of clothing, long before respondent filed its application or began use of the registered mark. Petitioner also pleaded ownership of Reg. No. 2351709 for the KING RANCH mark for "clothing for men, women and children, namely, jackets, shirts, T-shirts, shorts, pants, hats, caps, bandannas, belts, boots, blouses, skirts, dresses, vests, hunting vests, hunting pants and protective leggings." The registration, which is active, issued on May 23, 2000 from an application filed on May 4, 1999. The registration claims first use anywhere and first use in commerce on December 31, 1923.

Petitioner has filed a brief but respondent has not. Respondent appeared at an oral hearing but petitioner did not. For the reasons indicated below, we grant the petition for cancellation.

The Record

In addition to the file for the RANCH KING registration and the pleadings, the record includes the following: petitioner's testimonial depositions of Sharon Shaw and Rose Morales with exhibits; petitioner's notices of reliance on numerous printed publications and dictionary entries, status and title copies of certain registrations owned by petitioner including Reg. No. 2351709, [FN2] and certain responses by respondent to petitioner's interrogatories; respondent's affidavit by Chris I. Fitterling, submitted under a stipulation by the parties; respondent's notice of reliance on certain USPTO application and registration records, certain dictionary entries, and certain responses by petitioner to respondent's interrogatories.

Findings of Fact

Petitioner

Petitioner and its predecessors have operated the King Ranch, located principally in South Texas, since its establishment in 1853 by Captain Richard King. The South Texas King Ranch covers more than 1,300 square miles, an area larger than the State of Rhode Island. The ranch is home to over 50,000 cattle and 300 horses. By any measure, even Texas standards, the ranch is impressive in size. The ranch has also become known as a result of publicity extending over many decades. Petitioner has documented the history of the ranch and publicity about the ranch primarily through a wide range of publications and through the testimony of Sharon Shaw and Rose Morales. Each of the witnesses had been employed on the King Ranch for many years in a number of capacities, including in management positions related to the retail sale of goods under the KING RANCH mark.

***2** The King Ranch is a National Historic Landmark. The ranch was featured in a cover story in Time Magazine in 1947 and in LIFE Magazine in 1957. The King Ranch was also among the subjects featured in the "Cattle Barons" installment of the 1997 A&E television and video series entitled America's Castles. The King Ranch has also produced a Triple Crown winner, Assault. The ranch played a significant role in the development of the ranching business, most notably in breeding and raising cattle.

The references to the King Ranch in periodicals in the record consist principally of stories about subjects other than the ranch where a passing reference is made to the King Ranch. Adjectives, such as famous or renown, consistently modify "King Ranch" in these articles. The articles come from sources within Texas, as well as national and international publications.

The enterprises connected with the King Ranch extend from the traditional ranching businesses, including beef production, to oil wells, to tourism and the provision of a wide variety of goods under the KING RANCH trademark beginning with leather saddles dating from the early days of the ranch. The ranch has offered tours, including hunts, wildlife tours, bird-watching tours, museum and nature tours, some since as early as the 1920s and all since at least 1992.

The ranch began the retail sale of more typical consumer goods more recently. Petitioner states, "Petitioner, and its divisions and affiliates, sells (sic) a wide variety of goods and services under the KING RANCH mark. These include clothing, multi-purpose hand tools, gun cases, jewelry, pens, leather desk accessories, saddles, luggage, dinnerware, furniture, cutlery, golf towels and balls, food products, nature tours, and cattle breeding services, to name a few." Petitioner's Brief at 8 (footnotes omitted). Petitioner has also licensed the KING RANCH mark for use on a line of pickup trucks sold by the Ford Motor Company.

Petitioner sells its goods and services through catalogs, web sites, and in its own retail store operations on the ranch itself and in Kingsville, Texas. Petitioner currently mails approximately one million catalogs to potential customers each year; petitioner has mailed approximately eight million catalogs since 1992. Petitioner's hats bearing the KING RANCH mark are among the goods featured in those catalogs.

For our purposes, the most important products are petitioner's clothing, and in particular, hats. Through testimony and exhibits, including samples of catalogs, petitioner has established that it has used the KING RANCH mark on clothing, including hats, continuously since at least as early as 1992. The hats include caps and brimmed hats, such as straw hats and cowboy-style hats. Overall King Ranch has sold over $1,500,000 in hats under the KING RANCH mark from 1993 to 2003. The sales for all products sold under the KING RANCH mark from 1992 to 2003 are approximately $58 million.

***3** Petitioner advertises its goods and services, including clothing and hats, principally in local publications in South Texas, and to a limited extent in publications with wider circulation, such as Texas Monthly and Southern Living magazines, as well as magazines and catalogs distributed through national airlines. The record does not include any specific circulation figures for any publications in which petitioner advertises. From 1999 through 2000 petitioner spent approximately $21,000 in magazine advertising.

Respondent

The affidavit of Chris I. Fitterling is the primary source of information about the respondent and its use of the RANCH KING mark, apart from the particulars of the registration noted above. Mr. Fitterling is a vice president of a company related to respondent and, as a result of holding that position, Mr. Fitterling has actual knowledge of respondent's marketing of products under the RANCH KING mark. Respondent sells hats under numerous marks, including RANCH KING. Respondent sold over $1,200,000 in hats under the RANCH KING mark from June 1999 until November 11, 2003, the date of the Fitterling affidavit.

Mr. Fitterling was not aware that petitioner was a competitor, and furthermore, Mr. Fitterling was not aware of any confusion between the KING RANCH and RANCH KING marks. Mr. Fitterling stated his belief that the KING RANCH and RANCH KING marks created different commercial impressions because petitioner's mark referred to an individual with the KING surname and respondent's mark conveys "quality, superiority and leadership." Fitterling Affidavit at 4. Mr. Fitterling states that respondent's "channel of trade" for its goods sold under the RANCH KING mark is "our established distribution network." Id. There is no evidence in the record regarding the nature of that "network."

Analysis

Standing

Standing is a threshold inquiry in every inter partes case. In Ritchie v. Simpson, 170 F.3d 1092, 50 USPQ2d 1023 (Fed. Cir. 1999), the Federal Circuit has enunciated a liberal threshold for determining standing, that is, whether one's belief that one will be damaged by the registration has a reasonable basis in fact and reflects a real interest in the case. See also Jewelers Vigilance Committee Inc. v. Ullenberg Corp., 823 F.2d 490, 2 USPQ2d 2021, 2023 (Fed. Cir. 1987); and Lipton Industries, Inc. v. Ralston Purina Company, 670 F.2d 1024, 213 USPQ 185 (CCPA 1982). Petitioner has alleged and submitted evidence of use of its KING RANCH mark in connection with clothing, including hats, as well as other goods and services. We consider this evidence sufficient to establish petitioner's standing.

Priority

Because both petitioner and respondent own registrations, neither party has priority simply because it owns a registration. Brewski Beer Co. v. Brewski Brothers, Inc., 47 USPQ2d 1281, 1284 (TTAB 1998). In a case such as this, "... the registrations of each party offset each other... [and] petitioner as a plaintiff, must, in the first instance, establish prior rights in the same or similar mark..." Id.

***4** In this case, because respondent has not submitted any evidence of an earlier priority date, the earliest date upon which it can rely is the filing date of its underlying application, that is, February 1, 1999. Intersat Corp. v. International Telecommunications Satellite Organization, 226 USPQ 154, 156 n. 5 (TTAB 1985). Because petitioner's underlying application was not filed until May 4, 1999, petitioner is required to show use prior to February 1, 1999 to establish its priority. Petitioner has done so by establishing through competent evidence that it used the KING RANCH mark on clothing, including hats, at least as early as 1992, as noted in our findings of fact. Accordingly, petiioner has priority and the issue of likelihood of confusion is determinative in this case.

Likelihood of Confusion

The opinion in In re E. I. du Pont de Nemours & Co., 476 F.2d 1357, 177 USPQ 563, 567 (CCPA 1977), sets forth the factors to consider in determining likelihood of confusion. We must determine the issue of likelihood of confusion based on the evidence of record relating to the factors. In re Majestic Distilling Co., 315 F.3d 1301, 65 USPQ2d 1201, 1203-04 (Fed. Cir. 2003). Here, as is often the case, the crucial factors are the similarity of the marks and the similarity of the goods of the petitioner and respondent. Federated Foods, Inc. v. Fort Howard Paper Co., 544 F.2d 1098, 192 USPQ 24, 29 (CCPA 1976)("The fundamental inquiry mandated by Section 2(d) goes to the cumulative effect of differences in the essential characteristics of the goods and differences in the marks.").

The Goods and Channels of Trade - The goods of petitioner and respondent need not be identical to find likelihood of confusion under Section 2(d) of the Trademark Act. They need only be related in some manner or the circumstances surrounding their marketing must be such that they would result in relevant consumers mistakenly believing that the goods originate from the same source. On-Line Careline Inc. v. America Online Inc., 229 F.3d 1080, 56 USPQ2d 1471 (Fed. Cir. 2000).

Furthermore, in comparing the goods and channels of trade we must consider the goods as identified in the respondent's registration. See Octocom Systems, Inc. v. Houston Computers Services Inc., 918 F.2d 937, 16 USPQ2d 1783, 1787 (Fed. Cir. 1990). See also Paula Payne Products v. Johnson Publishing Co., 473 F.2d 901, 177 USPQ 76, 77 (CCPA 1973) ("Trademark cases involving the issue of likelihood of confusion must be decided on the basis of the respective descriptions of goods."). Because petitioner relies on common law rights acquired through use of its mark in addition to a registration, petitioner is not limited to those goods identified in its registration in the comparison of goods.

***5** The goods in respondent's registration are identified simply as "headwear." Petitioner has established earlier use of its KING RANCH mark on hats, a type of headwear. Accordingly, we conclude that the goods of the parties are identical.

Furthermore, in comparing the channels of trade for the goods, as we noted above, we must again consider the goods as identified in respondent's registration. Respondent's registration does not specify any trade-channel limitations. Accordingly, we must assume that respondent's goods travel in all usual trade channels for such goods. In view of the fact that the goods of the parties are identical, we conclude that the channels of trade and potential purchasers for respondent's goods are the same or overlapping with the petitioner's goods.

For completeness we also note that respondent's goods, as identified, could include relatively inexpensive headwear, for example, caps, an item which could be purchased with little deliberation, and an item which petitioner also sells under its mark. Furthermore, we note that, "the degree of similarity [between the marks] necessary to support the conclusion of likely confusion declines" when the goods are identical. Century 21 Real Estate Corp. v. Century Life of America, 970 F.2d 874, 23 USPQ2d 1698, 1701 (Fed. Cir. 1992), cert. denied, 506 U.S. 1034 (1992).

The Marks - In comparing the marks we must consider the appearance, sound, connotation and commercial impression of the marks at issue. Palm Bay Imports Inc. v. Veuve Clicquot Ponsardin Maison Fondee En 1772, 396 F.3d 1369, 73 USPQ2d 1689, 1692 (Fed. Cir. 2005).

In this case we have a classic example of two marks consisting of the same two words where the order of the words is inverted - KING RANCH versus RANCH KING. In such a case, the key to determining whether the marks are confusingly similar is whether the marks have different connotations or "create distinctly different commercial impressions." In re Nationwide Indus. Inc., 6 USPQ2d 1882, 1884 (TTAB 1988), citing, Bank of America National Trust and Savings Assn. v. American National Bank of St. Joseph, 201 USPQ 842 (TTAB 1978). Cf. In re Wine Society of America Inc., 12 USPQ2d 1139 (TTAB 1989).

In this case, petitioner argues that the commercial impressions of the two marks are the same. Specifically, petitioner argues that its KING RANCH mark suggests high quality and that respondent's RANCH KING mark does likewise by emulating petitioner's mark. Petitioner points to the "tradition of quality" associated with the King Ranch itself and the KING RANCH mark. Petitioner's Brief at 18. At oral argument, respondent argued, as the Fitterling affidavit alleges, that the commercial impressions of the marks differ because KING in petitioner's mark is a surname referring to the founder of the ranch and respondent's mark conveys no such meaning, but rather "quality, superiority and leadership." Fitterling Affidavit at 4.

***6** Both petitioner and respondent have submitted numerous dictionary definitions for both "king" and "ranch" in an apparent attempt to show, either respectively, that the marks do or do not convey the same or similar commercial impressions. Under these circumstances, the competing dictionary entries are not particularly probative or persuasive.

First, we note that the two marks are similar in both appearance and sound. Although the inversion of the words alters the appearance and sound, the difference is not significant. In fact, this appears to be one of the few cases addressing the inversion of word order where the two words are identical in all respects. See Bakers Franchise Corp. v. Royal Crown Cola Co., 404 F.2d 985, 160 USPQ 193 (CCPA 1969) (DIET RITE held confusingly similar to RITE DIET). Cf. In re Nationwide Indus. Inc., 6 USPQ2d at 1884 (RUST BUSTER held confusingly similar to BUST RUST); Bank of America National Trust and Savings Assn. v. American National Bank of St. Joseph, 201 USPQ at 8432 (AMERIBANC held confusingly similar to BANKAMERICA and BANK OF AMERICA).

With regard to connotation and commercial impression, we conclude that the marks are virtually identical in these respects. We are not persuaded by respondent's argument that potential purchasers will perceive the alleged surname significance of KING in petitioner's mark. We have no evidence either that potential purchasers of headwear will have detailed knowledge of the history of the King Ranch or that they would perceive a reference to Captain Richard King or any of his descendants in the KING RANCH mark when used on hats.

Rather, we conclude that both words KING and RANCH convey the same meanings in both marks, and that the combination of the words in both marks, though in inverse order, also conveys the same connotation and commercial impression. In both marks KING connotes something regal or superior, something of high quality, and RANCH connotes that the relevant goods are suitable for or otherwise associated with ranches or like places. The inversion in the order does nothing to alter these connotations or the commercial impressions of the marks. Accordingly, we conclude that the marks are similar overall.

Fame - Petitioner argues that its mark is famous, and therefore, entitled to a broad scope of protection. Petitioner has provided evidence of the long history of the King Ranch, as well as the notoriety the ranch has achieved, principally for its size and its role in the development of the ranching business. However, the use of the KING RANCH mark in connection with clothing, particularly hats, covers a period of just over ten years, and the sales and advertising related to hats sold under the KING RANCH mark over that period are modest in scope. In the absence of any evidence in the record which provides a context for sales of hats generally, other than the specific sales of petitioner and respondent under their respective marks, we conclude that petitioner's hat sales represent a relatively small share of the hat market.

***7** Accordingly, based on the entire record, we conclude that petitioner has shown only a de minimis degree of "renown" for the KING RANCH mark as applied to clothing, particularly hats. Any renown derives from the notoriety of the ranch generally. The degree of renown shown here would entitle petitioner to only a marginally broader scope of protection than would otherwise apply for its KING RANCH mark as applied to hats. Gillette Canada Inc. v. Ranir Corp., 23 USPQ2d 1768, 1774 (TTAB 1992). See Kenner Parker Toys Inc. v. Rose Art Industries Inc., 963 F.2d 350, 22 USPQ2d 1453, 1456 (Fed. Cir. 1992). The showing falls far short of that required to qualify the mark for inclusion in the select class of marks which are characterized as famous. See NASDAQ Stock Market Inc. v. Antarctica S.r.l., 69 USPQ2d 1718 (TTAB 2003). Furthermore, we note that we would reach the same conclusion on the ultimate question of likelihood of confusion with or without a finding of renown for petitioner's mark.

Actual Confusion - Respondent also appears to argue that there has been no actual confusion between its mark and petitioner's mark by relying on petitioner's interrogatory response indicating that petitioner was not aware of any confusion and Mr. Fitterling's assertion that he was not aware of any confusion. While we must presume overlapping channels of trade in comparing the goods because of governing precedent, in considering actual confusion, we must focus on whether there have been real opportunities for such confusion to occur. We find no evidence in this record indicating that there has been a significant opportunity for confusion. In this regard, we note that respondent has not even delineated the trade channels for its goods.

More importantly, we reject respondent's implied argument that the absence of actual confusion in this record supports its position generally. The Federal Circuit has stated, "A showing of actual confusion would of course be highly probative, if not conclusive, of a high likelihood of confusion. The opposite is not true, however. The lack of evidence of actual confusion carries little weight (citation omitted) ..." Majestic, 65 USPQ2d at 1205. See also In re Kangaroos U.S.A., 223 USPQ 1025, 1026-27 (TTAB 1984).

Accordingly, we conclude that the actual-confusion factor is neutral in this case.

Conclusion

Finally, we have considered all relevant evidence in this case bearing on the du Pont factors and conclude that there is a likelihood of confusion between petitioner's KING RANCH mark and respondent's RANCH KING mark. We conclude so principally because the goods are identical and the marks are similar in appearance and sound and virtually identical in connotation and commercial impression, and due to the strength of petitioner's KING RANCH mark.

***8** Decision: The petition for cancellation is granted on the ground of likelihood of confusion. The registration will be cancelled in due course.

FN1. In an order mailed August 9, 2006, the Board granted the motion by King Ranch, Inc., to substitute King Ranch IP, LLC as petitioner.

FN2. Although petitioner made numerous KING RANCH registrations of record, petitioner only pleaded Reg. No. 2351709. Accordingly, we have not considered the registrations which were not pleaded.

2007 WL 1144945 (Trademark Tr. & App. Bd.)

END OF DOCUMENT

APPENDIX 3

<u>Nextel Responses to Motorola Evidentiary Objections</u>

1. <u>Opposer's Second Notice of Reliance</u>

Applicant Objects to the entirety of Opposer's Second Notice of Reliance, which consists of testimony of Opposer's Rule 30(b)(6) witness, Allison O'Reilly, submitted by Opposer to clarify misleading portions of Ms. O'Reilly's testimony contained in Applicant's Notice of Reliance. Applicant's objections are unfounded and should be denied.

A. <u>Blackberry Testimony</u>

Applicant asserts that Ms. O'Reilly's testimony at p. 23 (lines 13-16), p. 25 (lines 15-19), p. 37 (lines 17-25), and p. 38 (lines 1-2), does not clarify misleading testimony relied on by Motorola at p. 25 (lines 1-10), and accuses Opposer of cherry-picking testimony. App. Br. at 46-47. Motorola's argument is baseless. Motorola relies on Ms. O'Reilly's testimony in its arguments regarding standing, and in particular to assert that Opposer has no reasonable apprehension of damage because Motorola is the only maker of Nextel handsets. *See* App. Br. at 14. This is not the case, as the portions of Ms. O'Reilly's testimony contained in Opposer's Second Notice of Reliance make clear.

B. <u>Distinctiveness Testimony</u>

Applicant objects to all testimony in Opposer's Second Notice of Reliance regarding distinctiveness. Consideration of the testimony relied on by Opposer shows the unsustainable logic of Applicant's objection.

Motorola's Notice of Reliance plucked portions of Ms. O'Reilly's testimony regarding distinctiveness when it was clear she did not understand the underlying legal principles of inherent distinctiveness and acquired distinctiveness. See, e.g., p. 35, line 16 to page 36, line 9. Absent an understanding of these concepts, Ms. O'Reilly could not provide factual basis for a question such as "The paragraph states in part 'The 911 Hz tone is not inherently distinctive.' What's the factual basis for that statement?" p. 33 (Lines 20-25). The portions of Ms. O'Reilly's testimony contained in Opposer's Second Notice of Reliance regarding distinctiveness correct the misleading statements selected by Applicant to create the impression that Ms. O'Reilly's responses were based on an understanding of the questions she was being asked on that issue. The Board should therefore deny Applicant's objection.

2. Opposer's First Notice of Reliance

Applicant objects to Section F of Opposer's First Notice of Reliance, consisting of documents produced by Applicant during discovery (Bates Nos. MOT 4773-4774 and MOT 4796-5451.) Applicant Br. at 48. Applicant's objection is without merit and should be denied.

The produced documents in question consist of the survey responses and coding key regarding those responses that form the empirical basis of the opinion offered in this opposition by Applicant's expert, Dr. Rappeport, on the issue of acquired distinctiveness. The documents are therefore admissible as admissions against party interest. *Borgatello v. C.I.R.*, 2000 WL 1172345, at *3 (Tax Ct. 2000)(Expert reports and underlying data admissible where expert who produced the reports did not testify at trial and his reports were not introduced by the estate because "[t]he act of producing the reports to respondent constitutes an adoption of belief in the truth of their contents pursuant to rule 801(d)(2)(B).")

In addition, Motorola did not produce Dr. Rappeport's survey and the underlying data, including Bates Nos. MOT 4773-4774 and MOT 4796-5451, until October 26, 2005, after the close of the discovery period. This late production prevented Opposer from issuing a Request for Admission regarding the documents, which would otherwise have provided a separate basis for admissibility.

Further, Motorola's own introduction of the same documents during the testimonial deposition of Dr. Rappeport renders the objection moot. Motorola asserts that reliance on the documents in question should be limited, but the application of such a premise is impracticable, and in any event, Motorola does not refer to any improper reliance by Opposer.

APPENDIX 4

C
Borgatello v. C.I.R.
U.S.Tax Ct.,2000.

United States Tax Court.
Estate of Charles A. BORGATELLO, Deceased, C. Norman Borgatello and Josephine E. Donnelly, Co-Executors, and C. Norman Borgatello, Successor Trustee to the Charles A. Borgatello Living Trust, Petitioners
v.
COMMISSIONER OF INTERNAL REVENUE, Respondent
No. 24756-97.

Aug. 18, 2000.

Executors petitioned for redetermination of estate tax deficiency arising from transfer of stock of closely-held corporation, whose primary assets were two shopping centers. The Tax Court, Wells, Chief Judge, held that discount of 33% to net asset value of corporation properly accounted for lack of marketability of stock.

Decision for taxpayer in part, and for IRS in part.
West Headnotes
[1] Internal Revenue 220 4621

220 Internal Revenue
220XXI Assessment of Taxes
220XXI(C) Evidence
220k4619 Admissibility
220k4621 k. Corporate Stock. Most Cited Cases
Valuation reports provided to Appeals officer regarding value of shopping malls, which were assets of corporation whose stock was held by estate, for estate tax purposes, were admissible evidence, despite that reports were not used in preparation of estate's tax return and were not provided to IRS during audit, since estate supplied reports to IRS as representations of values of the malls, and thereby adopted belief in truth of reports' contents. Fed.Rule Evid., Rule 801(d)(2)(B).

[2] Internal Revenue 220 4620

220 Internal Revenue
220XXI Assessment of Taxes
220XXI(C) Evidence
220k4619 Admissibility
220k4620 k. Value. Most Cited Cases
Valuation reports, not used for tax return or in audit, were admissible as evidence outside trial record, since they were relied on by an expert to formulate his opinion. Fed.Rule Evid., Rule 703.

[3] Internal Revenue 220 4620

220 Internal Revenue
220XXI Assessment of Taxes
220XXI(C) Evidence
220k4619 Admissibility
220k4620 k. Value. Most Cited Cases
Estates' secondary valuation reports, which estate sought to exclude due to IRS's valuation expert basing his report on background data of secondary reports, were admissible to aid trier of fact in understanding evidence; reports were not being offered as out-of-context conjecture or opinion which supported only one party's position. Fed.Rule Evid., Rule 702.

[4] Internal Revenue 220 4183.10

220 Internal Revenue
220VII Estate Taxes
220VII(B) Estates of Citizens or Residents
220k4183 Valuation
220k4183.10 k. In General. Most Cited Cases
Court has broad discretion in selecting valuation methods and weight to be given facts in reaching its decision, in determining estate tax consequences of transfers, since finding market value is something for judgment, experience, and reason. 26 U.S.C.A. § 2031(b).

[5] Internal Revenue 220 4183.10

220 Internal Revenue
220VII Estate Taxes
220VII(B) Estates of Citizens or Residents
220k4183 Valuation
220k4183.10 k. In General. Most Cited Cases
Fair market value standard, for estate tax, is objective, using a purely hypothetical willing buyer and seller who are presumed to be dedicated to

achieving maximum economic advantage in any transaction involving the property, which must be achieved in context of market and economic conditions on valuation date 26 U.S.C.A. § 2031(b); 26 C.F.R. § 20.2031-1(b).

[6] Internal Revenue 220 ⚿4184

220 Internal Revenue
220VII Estate Taxes
220VII(B) Estates of Citizens or Residents
220k4183 Valuation
220k4184 k. Corporate Securities. Most Cited Cases

Capitalization rate of 9.5% was within range of such rates in region for shopping malls held by closely-held corporation, for purpose of valuing stock for estate tax, and thus was a reasonable estimation of appropriate rate to use in valuing malls. 26 U.S.C.A. § 2031(b).

[7] Internal Revenue 220 ⚿4184

220 Internal Revenue
220VII Estate Taxes
220VII(B) Estates of Citizens or Residents
220k4183 Valuation
220k4184 k. Corporate Securities. Most Cited Cases

Reasonable adjustment to capitalization rate for shopping malls, to account for inflation, or leasing and selling commissions, was discount rate of 1.75%, for determining fair market value of malls held by corporation, whose stock was valued for estate tax purposes. 26 U.S.C.A. § 2031(b).

[8] Internal Revenue 220 ⚿4184

220 Internal Revenue
220VII Estate Taxes
220VII(B) Estates of Citizens or Residents
220k4183 Valuation
220k4184 k. Corporate Securities. Most Cited Cases

Appropriate duration of the cash-flow period for capitalizing earnings of shopping malls held by corporation, whose stock was valued for estate tax purposes, was 10 years, since that was the trend for real estate market in region where malls were situated 26 U.S.C.A. § 2031(b).

[9] Internal Revenue 220 ⚿4184

220 Internal Revenue
220VII Estate Taxes
220VII(B) Estates of Citizens or Residents
220k4183 Valuation
220k4184 k. Corporate Securities. Most Cited Cases

For estate tax valuation purposes, for unlisted stock, price at which sales of such stock are made in arm's-length transactions in open market is best evidence of value. 26 U.S.C.A. § 2031(b).

[10] Internal Revenue 220 ⚿4184

220 Internal Revenue
220VII Estate Taxes
220VII(B) Estates of Citizens or Residents
220k4183 Valuation
220k4184 k. Corporate Securities. Most Cited Cases

When valuing closely-held real estate holding company, for estate tax purposes, main emphasis was on company's assets, such that most reasonable valuation method was net asset value method, where corporation functioned as a holding, rather than operating, company, and earnings were relatively low in comparison to fair market value of underlying assets. 26 U.S.C.A. § 2031(b).

[11] Internal Revenue 220 ⚿4184

220 Internal Revenue
220VII Estate Taxes
220VII(B) Estates of Citizens or Residents
220k4183 Valuation
220k4184 k. Corporate Securities. Most Cited Cases

Using net asset value method to value stock in corporation whose primary assets were shopping malls required that discount for lack of marketability be applied to close-corporation's assets, and build-up method for discounts was useful framework to consider various factors in applying discount, since factors for which discount was applied could, thereby, be considered independently to arrive at aggregate discount; factors considered were shareholder dividends and compensation paid, local economy and real estate market, management continuity, built-in gains tax, restrictions on stock transfers, and transactional and other costs of disposing of property. 26 U.S.C.A. § 2031(b).

[12] Internal Revenue 220 ⚿4184

220 Internal Revenue
220VII Estate Taxes
220VII(B) Estates of Citizens or Residents
220k4183 Valuation
220k4184 k. Corporate Securities. Most Cited Cases

When arriving at value for corporation holding shopping malls, for estate tax purposes, factors that had already been taken into account in valuation of corporation's assets should not have been used in determining discount for lack of marketability; such duplicated factors would have been general economic conditions of region, cash-flow and dividend paying capacity. 26 U.S.C.A. § 2031(b).

[13] Internal Revenue 220 4184

220 Internal Revenue
220VII Estate Taxes
220VII(B) Estates of Citizens or Residents
220k4183 Valuation
220k4184 k. Corporate Securities. Most Cited Cases

In valuing closely-held corporation for estate tax purposes, management continuity was neutral factor, which did not negatively affect discount for lack of marketability, even though continuity of current management was unnecessary for company to succeed as a going concern; managing the company's real estate did not require expertise needed to oversee a management intensive operating company with many employees, and real estate holding company maintained low vacancy rates, which made it unlikely that any buyer would choose to employ current managers to oversee company's properties. 26 U.S.C.A. § 2031(b).

[14] Internal Revenue 220 4184

220 Internal Revenue
220VII Estate Taxes
220VII(B) Estates of Citizens or Residents
220k4183 Valuation
220k4184 k. Corporate Securities. Most Cited Cases

Application of discount for built-in capital gains tax was appropriate, as portion of total discount for lack of marketability, in valuing shopping malls held by close-corporation, for purposes of valuing its stock to determine estate tax liability, since a hypothetical buyer would have taken such tax consequences into account when arriving at amount he would be willing to pay for stock. 26 U.S.C.A. § 2031(b).

[15] Internal Revenue 220 4184

220 Internal Revenue
220VII Estate Taxes
220VII(B) Estates of Citizens or Residents
220k4183 Valuation
220k4184 k. Corporate Securities. Most Cited Cases

For purposes of calculating percentage amount by which built-in taxes reduced net asset value of corporation, for determining estate tax liability on stock held by decedent, the present value of future tax was divided by net asset value, rather than by only real estate and investment assets, since such approach would have excluded some assets and all liabilities. 26 U.S.C.A. § 2031(b).

[16] Internal Revenue 220 4184

220 Internal Revenue
220VII Estate Taxes
220VII(B) Estates of Citizens or Residents
220k4183 Valuation
220k4184 k. Corporate Securities. Most Cited Cases

Reasonable discount for net asset value of corporate stock to account for tax liability inherent in its assets was 24%, for estate tax purposes, where range of discount values attributable to tax on built-in gain presented by experts was 32.3%, if assets were immediately liquidated, to 20.5%, if assets were held for ten years. 26 U.S.C.A. § 2031(b).

[17] Internal Revenue 220 4184

220 Internal Revenue
220VII Estate Taxes
220VII(B) Estates of Citizens or Residents
220k4183 Valuation
220k4184 k. Corporate Securities. Most Cited Cases

Stock purchase agreement providing for right of first refusal to shareholders would have chilling effect on hypothetical sale, for estate tax valuation purposes, such that discount of 3% to net asset value of corporation was appropriate, as portion of total discount for lack of marketability. 26 U.S.C.A. § 2031(b).

[18] Internal Revenue 220 4184

220 Internal Revenue

220VII Estate Taxes
220VII(B) Estates of Citizens or Residents
220k4183 Valuation
220k4184 k. Corporate Securities. Most Cited Cases

Reasonable discount to net asset value of corporate stock to account for transaction costs of hypothetical sale, for estate tax valuation purposes, was 6%, as portion of total discount for lack of marketability. 26 U.S.C.A. § 2031(b).

John W. Ambrecht and Gregory Arnold, for petitioners.
Donna F. Herbert, for respondent.

MEMORANDUM OPINION

WELLS, Chief J.

***1** Respondent determined a deficiency of $3,424,504 in the Federal estate tax of the estate of Charles A. Borgatello (the estate). After concessions, the issues we must decide involve the fair market value of stock representing an 82.76-percent interest in Valley Improvement Co., Inc. (VIC) FN1 as of January 12, 1994. To value the 82.76-percent shareholder's interest in VIC, we must first decide the fair market value of two shopping centers owned by VIC, Montecito Village North (MVN) and Montecito Village South (MVS), as of January 12, 1994. The parties agreed on the value of VIC's other assets. Some of the facts have been stipulated and are incorporated herein by this reference. Unless otherwise noted, all section references are to the Internal Revenue Code, and all Rule references are to the Tax Court Rules of Practice and Procedure. Charles Borgatello died a resident of California. Mr. Borgatello died on July 12, 1993.

Background

For the purpose of valuing Mr. Borgatello's assets, the estate's executors elected the alternate valuation date of January 12, 1994. On the alternate valuation date, VIC owned 100 percent of MVN and MVS. VIC also owned other assets with a total value (pursuant to the parties' stipulations) of $3,188,000 (rounded).FN2 Per the parties' stipulations, on the alternate valuation date, VIC had total liabilities of $2,543,000. The net value of VIC's assets FN3 on the alternate valuation date equaled the values of MVN and MVS, plus $645,000 (assets of $3,188,000 minus liabilities of $2,543,000).

Discussion

The estate contends that the combined value of MVN and MVS is $13,375,000 (MVN, $8,375,000 and MVS, $5,000,000). On the basis of those values and the stipulated value of VIC's other assets, the estate contends that Mr. Borgatello's 1,037 shares of VIC stock are worth $7,542,101. Respondent contends that the combined value of MVN and MVS is $15,799,000 (MVN, $9,925,000 and MVS, $5,874,000). On the basis of those values and the stipulated value of VIC's other assets, respondent contends that Mr. Borgatello's interest in VIC is worth $9,930,000.

Procedural Issue

Before we tackle the issues of the fair market values of MVN and MVS and Mr. Borgatello's interest in VIC, we must first address an evidentiary issue concerning certain appraisal reports prepared by the experts in this case. The estate commissioned several appraisals of MVN and MVS. One of the real estate appraisers, Wayne Holden, was asked to value MVN and MVS as of the date of Mr. Borgatello's death. For this purpose, Mr. Holden produced a set of appraisals that he completed on January 14, 1994 (Holden I reports). Subsequently, the estate asked Mr. Holden to appraise MVN and MVS as of the alternate valuation date. Mr. Holden updated his previous appraisals in two letters dated February 21, 1994 (Holden II reports). The Holden II reports ostensibly adjusted Mr. Holden's conclusions regarding the shopping center values in the Holden I reports for changes in the real estate market during the 6 months between the date of Mr. Borgatello's death and the alternate valuation date. On the basis of the Holden II reports, the estate decided to elect the alternate valuation date.

***2** [1] During the audit of the instant case, the estate provided respondent with the Holden I and II reports. Later, during discussions with respondent's Appeals Office, the estate provided the Appeals officer with two reports by Carlos A. Cardenas (Cardenas reports) valuing MVN and MVS on the alternate valuation date. The Cardenas reports were not used in the preparation of the estate's tax return and were not provided to the Internal Revenue Service during the audit of the estate. At trial, the estate did not use the Holden I or II reports or the Cardenas reports. Instead, the estate used two new appraisals by Mr.

Holden (Holden III reports), which valued MVN and MVS on the alternate valuation date.

Respondent's valuation of MVN and MVS is based upon two appraisal reports (in a single bound volume) prepared by David Marx. Mr. Marx prepared a Limited Summary report in which he reviewed the Holden I, II, and Cardenas reports and adopted some background data and conclusions from those reports. In particular, Mr. Marx adopted background data pertaining to Montecito-Santa Barbara area vacancy rates and fair rental value. He also agreed with the estate's experts' analyses pertaining to highest and best use, zoning, site and improvement, and neighborhood description. The first two pages of each of Mr. Marx's reports contain cover letters dated March 7, 1999, from Mr. Marx to respondent's attorney. Both letters contain the following disclaimer:

This Limited Summary Report is valid only if another reviewer or entity is in possession of the [Holden I, Holden II, and Cardenas appraisals] * * *. The appraiser agreed on some of the factual data and issues in these reports, and these items were used in this Limited Summary Report as part of the analysis of the subject. The three appraisals being reviewed, will be relied upon as to facts concerning the site, improvements, zoning and other descriptions. The appraiser will not complete a zoning analysis, site & improvement analysis or Highest and Best Use or neighborhood descriptions. These items are found in the appraisals reviewed by David Marx, and are assumed to be valid. [Emphasis in the original.]

At the trial of the instant case, the estate objected to the admission of Mr. Marx's reports, the Cardenas reports, and the Holden I and II reports. The Court admitted, over the estate's objection, the Holden I and II reports into evidence. The Court conditionally admitted Mr. Marx's reports, but reserved ruling on the admissibility of the Cardenas reports. The Court instructed the parties to brief the admissibility of Mr. Marx's reports and the Cardenas reports.

The estate disputes the admissibility of Mr. Marx's reports on several grounds. Chiefly, however, the estate argues that the Cardenas reports are inadmissible hearsay pursuant to rule 802 of the Federal Rules of Evidence. Additionally, the estate argues that if the Cardenas reports were excluded, it would cause Mr. Marx's reports to become invalid in accordance with the above-quoted disclaimer. Respondent contends that the Cardenas reports are not hearsay because they constitute admissions by the estate.

***3** [2] Rule 801(d)(2)(B) of the Federal Rules of Evidence expressly provides that any statement offered against a party where that party has manifested an adoption or belief in the statement's truth is admissible. See Fed.R.Evid. 801(d)(2)(B). Statements admitted pursuant to rule 801(d)(2)(B) of the Federal Rules of Evidence are admissible only against parties who have adopted them or who bear a specified relationship to the declarant. See *Hospital Corp. of Am. v. Commissioner,* T.C. Memo.1996-559. In the instant case, the Cardenas reports were given to respondent before trial by the estate's counsel. The reports were not obtained by respondent directly from the estate's experts. The estate supplied the reports to respondent as representations of the values (and the data underlying those values) of MVN and MVS. The act of producing the reports to respondent constitutes an adoption of belief in the truth of their contents pursuant to rule 801(d)(2)(B) of the Federal Rules of Evidence. Consequently, we hold that the requirements of rule 801(d)(2)(B) of the Federal Rules of Evidence are satisfied and the Cardenas reports are admissible.[FN4]

The estate vaguely suggests that the Cardenas reports were provided to respondent during settlement negotiations and, therefore, are inadmissible pursuant to rule 408 of the Federal Rules of Evidence. Although respondent acknowledged at trial that there may be some question as to whether the Cardenas reports were provided to respondent during settlement negotiations, the estate failed to demonstrate that such was the case. Consequently, we hold that the estate has not shown that the Cardenas reports are inadmissible pursuant to rule 408 of the Federal Rules of Evidence.

The estate's other main argument against the admission of Mr. Marx's report is based upon our holding in *Diego Investors IV v. Commissioner,* T.C. Memo.1989-630. In *Diego Investors IV,* the Court refused to allow an expert selected and paid for by the Commissioner to testify as the taxpayers' witness. The taxpayers in *Diego Investors IV* sought to call the Commissioner's expert to enhance their tactical position by using selected portions of a report pertaining to sales data while refuting the remainder of the expert's unfavorable conclusions. Although *Diego Investors IV* is distinguishable from the instant case in numerous ways, one critical distinction is that in the instant case, respondent has gained no tactical advantage by adopting some of the information in the estate's expert's reports.

[3] In the instant case, the estate provided the Holden I, II, and Cardenas reports to respondent as evidence of the values of MVN and MVS, as well as to provide the facts and data underlying those values. The estate now seeks to exclude those reports because they believe that if they are successful, we shall conclude that Mr. Marx's reports are invalid based on the language in Mr. Marx's disclaimer. However, it appears that the estate failed to appreciate that the use of expert testimony is within the sound discretion of the trial judge. The test for admissibility of expert testimony is whether the testimony will aid the trier of fact to understand the evidence. See Fed.R.Evid. 702; *United States v. Amaral*, 488 F.2d 1148, 1152 (9th Cir.1973). Under Rule 702 of the Federal Rules of Evidence, the trial judge is given broad discretion in his role as gatekeeper to decide what evidence is relevant, reliable, and helpful to the trier of fact. See *Desrosiers v. Flight Intl. of Fla., Inc.*, 156 F.3d 952, 961 (9th Cir.1998). In the instant case, the estate's experts' reports are being offered to aid the Court in understanding Mr. Marx's report. They are not being offered to refute the unfavorable conclusions of the estate's experts, nor are they being offered for a matter of out-of-context conjecture or opinion which supports only one party's position, as was the case in *Diego Investors IV.* Respondent gained no real tactical advantage in the instant case when Mr. Marx adopted information from the estate's experts' reports. The use of such reports is tantamount to an informal stipulation which saves the Court time in deciding a case that could have been settled by the parties. Indeed, such information should have been incorporated into a formal stipulation. We hold that the Marx and Cardenas reports are admitted into evidence.

Fair Market Value of the MVS and MVN Shopping Centers

***4** As is customary in valuation cases, the parties in the instant case rely primarily on expert opinion evidence to support their contrary valuation positions. In such cases, we evaluate the opinions of experts in light of the demonstrated qualifications of each expert and all other evidence in the record. See *Estate of Christ v. Commissioner*, 480 F.2d 171, 174 (9th Cir.1973), affg. 54 T.C. 493, 1970 WL 2362 (1970); *Parker v. Commissioner*, 86 T.C. 547, 561, 1986 WL 22106 (1986). We have broad discretion to evaluate " 'the overall cogency of each expert's analysis." ' *Sammons v. Commissioner*, 838 F.2d 330, 334 (9th Cir.1988) (quoting *Ebben v. Commissioner*, 783 F.2d 906, 909 (9th Cir.1986), affg. in part and revg. in part T.C. Memo.1983-200), affg. in part and revg. in part on another ground T .C. Memo.1986-318.

Expert testimony sometimes aids the Court in determining values, and sometimes it does not. See, e.g., *Estate of Halas v. Commissioner*, 94 T.C. 570, 577, 1990 WL 40948 (1990); *Laureys v. Commissioner*, 92 T.C. 101, 129, 1989 WL 4225 (1989) (stating that expert testimony is not useful when the expert is merely an advocate for the position argued by one of the parties). We are not bound by the formulas and opinions proffered by an expert witness and shall accept or reject expert testimony in the exercise of sound judgment. See *Helvering v. National Grocery Co.*, 304 U.S. 282, 295, 58 S.Ct. 932, 82 L.Ed. 1346 (1938); *Estate of Newhouse v. Commissioner*, 94 T.C. 193, 217, 1990 WL 17251 (1990). Where necessary, we may reach a determination of value based on our own examination of the evidence in the record. See *Silverman v. Commissioner*, 538 F.2d 927, 933 (2d Cir.1976), affg. T.C. Memo.1974-285; *Estate of Davis v. Commissioner*, 110 T.C. 530, 538, 1998 WL 345523 (1998). Where experts offer divergent estimates of fair market value, we decide what weight to give these estimates by examining the factors they used in arriving at their conclusions. See *Casey v. Commissioner*, 38 T.C. 357, 381, 1962 WL 1092 (1962).

[4] We have broad discretion in selecting valuation methods, see *Estate of O'Connell v. Commissioner*, 640 F.2d 249, 251 (9th Cir.1981), affg. on this issue and revg. in part T.C. Memo.1978-191, and the weight to be given the facts in reaching our conclusion because "finding market value is, after all, something for judgment, experience, and reason", *Colonial Fabrics, Inc. v. Commissioner*, 202 F.2d 105, 107 (2d Cir.1953), affg. a Memorandum Opinion of this Court. Moreover, while we may accept the opinion of an expert in its entirety, see *Buffalo Tool & Die Manufacturing Co. v. Commissioner*, 74 T.C. 441, 452, 1980 WL 4569 (1980), we may be selective in the use of any part of such opinion, or reject the opinion in its entirety, see *Parker v. Commissioner, supra* at 561. Because valuation necessarily results in an approximation, the figure at which this Court arrives need not be one as to which there is specific testimony if it is within the range of values that may properly be arrived at from

consideration of all the evidence. See *Estate of O'Connell v. Commissioner, supra* at 252; *Silverman v.. Commissioner, supra* at 933.

***5** [5] Real estate valuation is a question of fact resolved on the basis of the entire record. See Ahmanson Found. v. United States, 674 F.2d 761, 769 (9th Cir.1981); Estate of Fawcett v. Commissioner, 64 T.C. 889, 898, 1975 WL 3029 (1975). The trier of fact must weigh all relevant evidence to draw the appropriate inferences. See Commissioner v. Scottish Am. Inv. Co., 323 U.S. 119, 123-125, 65 S.Ct. 169, 89 L.Ed. 113 (1944); *Helvering v. National Grocery Co., supra* at 294-295; *Estate of Newhouse v. Commissioner, supra* at 217. The standard for valuation is fair market value, which is defined as the price that a willing buyer would pay a willing seller, both persons having reasonable knowledge of all relevant facts and neither person being under a compulsion to buy or to sell. See sec. 20.2031-1(b), Estate Tax Regs.; see also United States v. Cartwright, 411 U.S. 546, 551, 93 S.Ct. 1713, 36 L.Ed.2d 528 (1973); Estate of Simplot v. Commissioner, 112 T.C. 130, 151, 1999 WL 152610 (1999). The standard is objective, using a purely hypothetical willing buyer and seller who are presumed to be dedicated to achieving maximum economic advantage in any transaction involving the property, see *Estate of Simplot, supra* at 152, which must be achieved in the context of market and economic conditions at the valuation date, see *Estate of Newhouse v. Commissioner, supra* at 218.

There are generally three kinds of valuation methods used to determine the fair market value of real property: (1) The comparable sales method, (2) the income method, and (3) the cost method. See Marine v. Commissioner, 92 T.C. 958, 983, 1989 WL 47992 (1989), affd. without published opinion 921 F.2d 280 (9th Cir.1991). Variously using these methods, the appraisers in the instant case estimated the property values as follows:

Montecito Village North Appraisal Method	Holden	Marx
Income approach (Discounted cash-flow)	$8,375,000	$9,925,000
Sales comparison	7,900,000	10,369,000
Cost [1]	-	-

Montecito Village South Appraisal Method	Holden	Marx
Income approach (Discounted cash-flow)	$5,000,000	$5,874,000
Sales comparison	4,900,000	5,972,000
Cost	4,600,000	-

FN1. Mr. Holden performed a cost approach analysis for Montecito Village North, but only for the date of death, not the alternate valuation date. The date of death value was determined by Mr. Holden to be $10,225,000.

Although the parties used more than one method to value MVN and MVS, each expert relied most heavily on a version of the income method called the discounted cash-flow method. The sales comparison and the cost approach methods played insignificant roles in their analyses and appear to have little effect on Mr. Holden's and Mr. Marx's bottom line valuations.FN5 The income method, on the other hand, is embraced by both Mr. Marx and Mr. Holden and dominates their analyses. Because the parties' main focus is on the income method of valuing MVN and MVS, our focus, too, will be on the income valuation method.

***6** The parties in the instant case rely on a version of the income valuation method called the discounted cash-flow (DCF) method. The DCF method is a set of procedures in which an appraiser specifies the quantity, variability, timing, and duration of periodic income, as well as the quantity and timing of reversions, and discounts each to its present value at a specified yield. In formulating their DCF analyses, each expert in the instant case uses different input assumptions but their cash-flow estimates end up being very similar.FN6 The main reason the parties arrive at different values for MVN and MVS is that their experts make different assumptions concerning the discount rate.FN7

Both Mr. Marx and Mr. Holden arrive at a discount rate by abstracting sales of comparable commercial properties in order to derive a capitalization rate. The capitalization rate is the property's cash-flow divided by its sales price. The discount rate is ascertained by making adjustments to the capitalization rate, primarily for inflation. Mr. Holden's capitalization rate was derived from a pool of comparable sales more extensive than Mr. Marx's capitalization rate. Most of Mr. Holden's comparables, however, are properties located in places outside the Montecito-Santa Barbara area, such as Oxnard and Los Angeles, California. Indeed, we find that aspect of Mr. Holden's analysis troubling. MVN and MVS are located in an area adjacent to the city of Santa Barbara. MVN and MVS are more than 90 miles away from Mr. Holden's comparables in Huntington Beach and Los Angeles, and more than 30 miles away from Oxnard.

Mr. Holden acknowledges that MVN and MVS are "situated in Santa Barbara's most desirable neighborhood". He also notes that MVN and MVS "make up the majority of the commercial property in Montecito. They almost set their own rental market." The Montecito-Santa Barbara community is unique in that there is very limited vacant land. It is a small community, and there are not many shopping centers for sale at any given time, in contrast to Los Angeles and Orange counties where many shopping centers are for sale at any particular moment in time. Moreover, during 1989, Santa Barbara voters passed "Measure E", which restricts the building of commercial and industrial properties in the city limits of Santa Barbara. Mr. Holden states that, although it is too early to tell how Measure E would affect the real estate market in Santa Barbara, "more than likely, it will cause a shortage of commercial rental facilities and create high rents". Accordingly, the unique character of the Montecito-Santa Barbara real estate market will be maintained well after the alternate valuation date.

[6] Mr. Holden attempted to demonstrate the rising capitalization rates of commercial shopping center sales in southern California.FN8 However, because of the unique character of the Montecito-Santa Barbara area, we are primarily concerned only with how the softness in the real estate market was affecting capitalization rates in that area. Mr. Holden reported that sales in the Santa Barbara area during the time in question commanded capitalization rates of 9.17 percent and 9.4 percent. Mr. Marx researched three additional sales in Santa Barbara during 1993 and 1994 and found capitalization rates ranging from 7.83 percent to 9.4 percent. On the basis of such data, Mr. Marx concludes that an overall capitalization rate of 9.25 percent to 9.5 percent is appropriate in valuing MVN and MVS. He settles on 9.5 percent as the capitalization rate. Mr. Holden, on the other hand, went outside the Santa Barbara area in order to justify a higher capitalization rate for MVN and MVS. In his view, southern California was experiencing a soft real estate market at the time of the alternate valuation date. Mr. Holden fails to explain, however, why any market softness is not already reflected in the capitalization rates of the Montecito-Santa Barbara area comparables. We are inclined to keep the capitalization rate in the instant case within the range of capitalization rates found in the Montecito-Santa Barbara area at or near the time of the alternate valuation date. MVN and MVS are uniquely situated because of the lack of commercial rental property in the area. Mr. Holden fails to convince the Court that his use of widespread, southern California comparables is appropriate in analyzing MVN and MVS. We are persuaded, therefore, that a capitalization rate of 9.5 percent is in line with capitalization rates generally in the Montecito-Santa Barbara area at the alternate valuation date and is a reasonable estimation of the appropriate capitalization rate to use in valuing MVN and MVS.

*7 [7] As stated above, the discount rate is a derivative of the capitalization rate. Messrs. Holden and Marx agree that a 2-percent adjustment is needed to account for inflation. Mr. Marx makes a further adjustment that considers leasing and selling commissions along with absorption and tenant improvement issues, which reduces Mr. Marx's capitalization rate adjustment by approximately one-half of a percent. Mr. Holden makes no such adjustment. Given the range of estimated adjustments suggested by the experts, we find that 1.75 percent is a reasonable adjustment to the capitalization rate in order to arrive at the appropriate discount rate.

[8] Another area of disagreement among the experts is the appropriate duration of the cash-flow period. Mr. Holden uses a 7-year cash-flow period whereas Mr. Marx uses a 10-year cash-flow period. Mr. Holden justifies his 7-year period on the basis of, inter alia, market uncertainties and the fact that as the cash-flow period is extended into the future, the analysis becomes less reliable. Mr. Holden also notes that real estate markets tend to flow in 7-year cycles. Mr. Marx points out that a 10-year cash-flow period is supported by information from local brokers and national real estate publications. Although 7 years may be a reasonable cash-flow period in some cases, we are inclined to follow the trends of the Montecito-Santa Barbara real estate market. We find, therefore, that Mr. Marx's estimate of a 10-year cash-flow period is persuasive because it follows more closely Santa Barbara's real estate norms.

On the basis of the foregoing discussion, we find Mr. Holden's valuation estimates to be too low and find Mr. Marx's estimates to be too high. We believe that $9,600,000 is a reasonable estimate of the value of MVN and $5,680,000 is a reasonable estimate of the value of MVS. With such values in mind, we now proceed to value Mr. Borgatello's interest in VIC.

Value of Mr. Borgatello's Interest in VIC

[9] Knowing the value of MVS and MVN, we are now able to decide the price at which Mr. Borgatello's 82.76 percent stock interest in VIC "would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of the relevant facts." Sec. 20.2031-1(b), Estate Tax Regs. In the case of unlisted stock, such as the stock in question, the price at which sales of such stock are made in arm's-length transactions in an open market is the best evidence of value. See *Estate of Davis v. Commissioner*, 110 T.C. 530, 535, 1998 WL 345523 (1998). The record in the instant case does not contain any such sale of stock. Where the value of unlisted stock cannot be determined from actual sale prices, its value generally is to be determined by taking into consideration a host of factors, including, among others, the company's net worth, prospective earning power, and dividend-paying capacity. See, e.g., *Estate of Davis, supra* at 536.

[10] When valuing a real estate holding company, however, the main emphasis is on the company's assets. See *id.* The net asset value method is the most reasonable one to use in a case such as the instant case, where the corporation functions as a holding, rather than an operating, company and earnings are relatively low in comparison to the fair market value of the underlying assets. See, e .g., *Estate of Davis v. Commissioner, supra; Estate of Piper v. Commissioner*, 72 T.C. 1062, 1069-1070, 1979 WL 3788 (1979). The net asset value method involves arriving at the company's net asset value (the value of the company's assets less liabilites, where the assets have been adjusted to reflect their fair market value) and then discounting that value to account for various factors that affect its marketability. Principal factors affecting the discount in the instant case are the tax liability inherent in the built-in gain assets of VIC and the lack of marketability due to the difficulty of selling stock in a small closely held corporation such as VIC. We do not employ a fixed formula in considering the factors that we use to determine the fair market value of unlisted stock. See *Estate of Davis, supra* at 536. The weight to be given to the various factors in arriving at fair market value depends upon the facts of each case. See sec. 25.2512-2(f), Gift Tax Regs. We have broad discretion in assigning weight to the various factors and in selecting the method of valuation. See *Estate of O'Connell v. Commissioner*, 640 F.2d 249, 251-252 (9th Cir.1981), affg. on this issue and revg. in part T.C. Memo.1978-191; sec. 25.2512-2(f), Gift Tax Regs. The determination of the value of closely held stock is a matter of judgment rather than one of mathematics. See *Estate of Davis, supra* at 537. Moreover, because the valuation is necessarily an approximation, it is not required that the value that we determine be one as to which there is specific testimony, provided that it is within the range of figures that properly may be deduced from the evidence. See *id.*

***8** [11] As in most valuation cases, the parties in the instant case rely extensively on the opinions of their respective experts to support their differing views about the fair market value on the valuation date. Each expert utilizes the net asset value method in order to value Mr. Borgatello's interest in VIC. For purposes of determining the appropriate discount to be applied to VIC's assets, the estate introduced the report of James Brockardt, who asserts that the net asset value of VIC should be discounted by 35 percent for lack of marketability. Respondent offered the report of Roger Wilde, who asserts that VIC's net asset value should be discounted by 27 percent for lack of marketability.

Mr. Wilde arrives at his discount using a build-up method. Mr. Wilde examines various factors and assigns a percentage value to each. Some factors increase and some decrease the net asset value discount. Wilde made the following adjustments to be included in the discount for lack of marketability:

1.	Shareholder dividends and compensation paid	5%
2.	Local economy and real estate market at 1/12/94	+ 5%
3.	Management continuity	2%
4.	Potential corporate gain and tax	+ 19%
5.	Restrictions on stock transfer	+ 3%
6.	Transaction and other costs	+ 7%

Mr. Brockardt, on the other hand, presents a general discussion of various factors, but does not assign a percentage value to any of them. He bases his total discount on his judgment and consideration of the factors as a whole. Thus, for example, Mr. Wilde reveals exactly how much of a discount he allows for the built-in gains in the assets of VIC, whereas with Mr. Brockardt's report, we do not know how much of the discount was attributable to built-in gains. Mr. Wilde's build-up method presents a useful framework to consider the various factors at play in the instant case. Below, we consider those factors within his framework and in light of Mr. Brockardt's report.

Mr. Wilde reduces the discount by 5 percent because of VIC's "consistent and strong cash-flow (dividend payment capability) and low vacancy rate of the [VIC's] shopping centers." Mr. Wilde further states: "The Company's financial statements and dividend policy indicate that the company has paid nominal dividends, but does pay the controlling shareholder significant salary. This would be a favorable factor for an investor in the shares being valued."

[12] Messrs. Marx and Holden accounted for the cash-flow provided by the properties and the economic conditions of the Santa Barbara area in their valuations of MVN and MVS. The estate argues that when arriving at a value for the corporation, we should not consider factors that have already been taken into account in the valuation of VIC's assets. We agree with the estate.

As pertains to cash-flow and dividend paying capacity, Section 5 of Rev. Rul. 59-60, 1959-1 C.B. 243, provides in pertinent part:
(b) The value of the stock of a closely held investment or real estate holding company, whether or not family owned, is closely related to the value of the assets underlying the stock. For companies of this type, the appraiser should determine the fair market values of the assets of the company. Operating expenses of such a

company and the cost of liquidating it, if any, merit consideration when appraising the relative values of the stock and the underlying assets. *The market values of the underlying assets give due weight to potential earnings and dividends of the particular items of property underlying the stock,* capitalized at rates deemed proper by the investing public at the date of appraisal. A current appraisal by the investing public should be superior to the retrospective opinion of an individual. For these reasons, adjusted net worth should be accorded greater weight in valuing the stock of a closely held investment or real estate holding company, whether of not family owned, than any of the customary yardsticks of appraisal, such as earnings and dividend paying capacity. [Emphasis added.]

***9** The revenue ruling implies that potential earnings are already accounted for in the market value of MVN and MVS and should not be considered again in valuing the VIC stock. As pertains to economic conditions and the softness in the real estate market, in *Estate of Berg v. Commissioner,* T.C. Memo.1991-279, affd. in part and revd. and remanded in part on another ground 976 F.2d 1163 (8th Cir.1992), we stated:The values arrived at by * * * [the expert] were the basis for the date of death values of the corporate properties. * * * Because in appraising the properties * * * [the expert] took into account the market for such property, as well as general economic conditions in Grand Forks, the fair market value of Vaberg's corporate assets, and therefore the fair market value of 100 percent of the Vaberg stock, has already been adjusted for such conditions.
To the extent that the market for residential real estate and general economic conditions would have a negative impact on the fair market value of the 26.92 percent of Vaberg stock held by the decedent, petitioner has already reduced the reported value of the stock on account of such impact. For this Court to adjust the discounts for minority interest and lack of marketability for these factors would be to duplicate the reduction in reported value due to such factors.

On the basis of our reasoning in *Estate of Berg, supra,* Mr. Wilde's 5-percent increase in the net asset value discount attributable to the general economic conditions of the Santa Barbara area is inappropriate. Similarly, the 5-percent decrease in the net asset value discount attributable to Mr. Wilde's consideration of VIC's cash-flow and ability to pay dividends is inappropriate pursuant to the reasoning of Rev. Rul. 59-60, 1959 C.B. 243, which is consistent with our conclusion in the instant case. The estate additionally contends that Mr. Wilde's adjustment for "Management Continuity" is already reflected in the value of MVN and MVS. We do not agree.

[13] It is not evident that Mr. Wilde's "Management Continuity" factor is reflected in the value of MVN and MVS or VIC's other assets. The estate incorrectly equates Mr. Wilde's discussion of management continuity with the management costs associated with overseeing MVN and MVS. Such management costs are indeed reflected in the value of MVN and MVS. What we believe Mr. Wilde refers to in his brief discussion of management continuity is that managing VIC's real estate does not require the expertise needed to oversee a management intensive operating company with many employees. Because VIC is a real estate holding company that maintains low vacancy rates in its properties (1 percent of total square footage vacant in a sluggish market), Mr. Wilde concludes that "The likelihood of a buyer being able to successfully manage the real estate holdings is strong." Indeed, it seems likely that any buyer of VIC will choose not to employ VIC's current managers to oversee the company's properties. Continuity of the current VIC management is unnecessary for the company to succeed as a going concern. The question then becomes whether Mr. Wilde's management continuity factor affects the discount in the manner he suggests. We tend to think it does not. Mr. Wilde reduces the net asset value discount by 2 percent for the management continuity factor, but we think the factor is neutral. Consequently, we do not assign any weight to it.

***10** [14] We shall assign weight to the consideration of the built-in capital gain tax inherent in VIC's assets. We may allow the application of a built-in capital gains tax discount if we believe that a hypothetical buyer would have taken into account the tax consequences of the built-in capital gains when arriving at the amount he would be willing to pay for Mr. Borgatello's VIC stock. See *Estate of Davis v. Commissioner,* 110 T.C. at 550-554; *Estate of Jameson v. Commissioner,* T.C. Memo.1999-43. Both parties agree in the instant case that a willing buyer would consider those tax consequences, but they disagree on how much to discount the net asset value to account for this factor.

The largest portion of Mr. Wilde's net asset value discount is attributable to the built-in gains inherent in VIC's assets. In calculating the discount attributable to the tax on the built-in gains, Mr. Wilde utilizes a 10-year holding period for the assets. Assuming a 2-percent growth rate, Mr. Wilde estimates the value of VIC's assets to be $22,214,089 for the year 2004. On the basis of such estimated value, Mr. Wilde calculates the built-in gain and applies California's 9.3 percent capital gains rate and a 34-percent Federal income tax rate to arrive at a future tax in 2004 in the amount of $7,500,008. Applying a discount rate of 8.3 percent (Long Term AFR + 2 percent for added risk), Mr. Wilde determines the present value of the future tax to be $3,378,914. In order to arrive at the discount attributable to the future tax, Mr. Wilde divided $3,378,914 (the present value of the future tax) by $18,223,290 (the total value of VIC's real estate and investments) to arrive at a 19-percent (rounded from 18.5 percent) discount. Accordingly, Mr. Wilde's discount is not calculated as a percentage of net asset value; rather, it is calculated as a percentage of the value of VIC's real estate and investment property. Mr. Wilde errs in calculating the discount attributable to the tax on the built-in gain this manner.

[15] Mr. Wilde errs in that the present value of the future tax should have been stated as a percentage of net asset value, not as a percentage of only VIC's real estate and investments. The estate correctly points out that the figure that Mr. Wilde arrives at "is irrelevant for purposes of calculating the percentage amount by which the taxes reduce the net asset value, because it excludes some assets and all liabilities." As a percentage of net asset value, the discount amount would not be 19 percent. The present value of the future tax, $3,378,914, divided by Mr. Wilde's net asset value, $16,443,000 produces a 20.5-percent discount. Accordingly, after correcting that error, the discount attributable to the tax on the built-in gains inherent in VIC's assets would be 20.5 percent, not 18.5 percent rounded to 19 percent.

Mr. Brockardt does not engage in the kind of explicit analysis in which Mr. Wilde engages, but Mr. Brockardt does calculate, on the basis of Mr. Holden's valuations of MVN and MVS, the impact of an immediate tax on the net asset value of VIC. According to Mr. Brockardt, an immediate tax on the built-in gains would warrant a 31.2-percent discount in the net asset value of VIC. On the basis of our valuations of MVN and MVS, an immediate tax on the built-in gain would warrant a 32.3-percent discount in the net asset value of VIC. [FN9] Applying that amount as a discount to the net asset value is unrealistic because it does not account for any holding period for the assets. The estate's expert concedes that there would be some period of tax deferral although he did not articulate how long the period of deferral would be. Mr. Wilde assumes a 10-year holding period for the assets. Adjusting Mr. Wilde's figures for our lower valuation of the shopping centers does not yield a different percentage value.[FN10]

***11** [16] The range of discount values attributable to the tax on the built-in gain in VIC's assets presented by the experts is 32.3 percent (if the assets are immediately liquidated) to 20.5 percent (if the assets are held for 10 years). Although there is no evidence that a willing buyer of VIC would immediately liquidate the assets, there is also not much support for respondent's contention that a buyer would wait 10 years before liquidating the assets. In reaching a middle ground, therefore, we find it reasonable to discount the net asset value by 24 percent to account for the tax liability inherent in VIC's assets.

[17] One of petitioner's main contentions for discounting the VIC stock is the presence of a stock purchase agreement. Although we believe that such agreement would have some chilling effect on a hypothetical sale, we do not agree that it would have the effect that the estate contends it would have. The agreement provides that before Mr. Borgatello or his estate sells his VIC shares, he must first offer his shares to the other VIC shareholders on pro rata basis at the price offered to the outside buyer. The other shareholders have 15 days to exercise their right of first refusal, and they may purchase any amount of the shares offered. After that 15-day period expires, VIC has the option of buying as many shares as it desires. After the consecutive 15-day periods expire, Mr. Borgatello could then sell the remaining shares to the third-party buyer.

The estate contends that the stock purchase agreement will inevitably lead to Mr. Borgatello's 82.76 percent block being sold in two smaller blocks because the minority shareholders will purchase just enough of the shares to gain control of VIC, leaving the third-party buyer with a minority interest. The estate, however, does not offer any evidence to prove that any of the VIC minority shareholders possess the means or the inclination to purchase enough of the stock to force Mr. Borgatello's 82.76 percent block to be sold in two smaller blocks. More importantly, our analysis presumes that the transaction involves a willing buyer and a willing seller under no particular compulsion to enter into a transaction. We seriously doubt that a willing seller under no compulsion to sell would dispose of an 82.76-percent block of stock in the manner suggested by the estate. What is more likely is that the buyer and seller would seek assurances from the other shareholders that they would not interfere in the transaction by exercising their rights pursuant to the stock purchase agreement. This would add some uncertainty and a chilling effect to the transaction, but not to the extent that the estate argues. Consequently, we accept respondent's assessment of the stock purchase agreement and discount the net asset value by 3 percent for that factor.

[18] The final adjustment Mr. Wilde makes to the net asset value accounts for transaction costs associated with the eventual sale of the assets. Mr. Wilde's estimation of these transaction costs is 7 percent of the net asset value.

In an immediate liquidation, Mr. Brockardt estimates these costs to be 5.7 percent of the net asset value. Given the narrow range of these figures, we think a 6-percent discount for transaction costs is a reasonable estimate.

***12** In sum, a total discount of 33 percent accounts properly for the lack of marketability of the VIC stock. Discounting the net asset value by 33 percent leads to a valuation adjustment of $5,255,016. On the basis of the foregoing examination of the record we conclude that the fair market value of Mr. Borgatello's VIC shares is as follows:

Net asset value	$15,924,290
Less: Valuation adjustment	5,255,016
Aggregate fair market value	$10,669,274
Fair market value per share (1253 shares outstanding)	$8,515
Fair market value of 1037 shares	$8,830,038
To reflect the foregoing,	

Decision will be entered pursuant to Rule 155.

FN1. Valley Improvement Co. is a California C corporation.

FN2. The value of the other assets is as follows:

Real Property	Fair Market Value
550 Santa Angela Lane	$425,000
Monterey county Ranch (remainder interest)	325,000
15.8 acres of vacant land outside Solvang (50% interest)	170,000
1562 Alamo	475,000

Pintado outside of Solvang	
Seven Properties zoned M-1 in Santa Barbara	
130 Nopalitos	140,000
126 Nopalitos	61,595
710 Kimball Street	87,785
712 Kimball Street	101,850
718 Kimball Street	101,850
713 Carpinteria Street	101,850
119 Powers Avenue	91,180
Total	$2,081,110
Tangible Personalty	
Equipment & cattle	$195,000
Total	$195,000
Investments	Fair Market Value
Chevron Corp. stock	$25,974
Pepsico, Inc. stock	154,319
Transamerica Corp. stock	79,463
General Motors stock	14,457
General Motors E stock	1,808
General Motors H stock	709
Western art	66,450
Total	$343,180
Other	Fair Market

Assets	Value
Cash	$72,000
Accounts and notes receivable	293,000
Other current assets	151,000
Other assets	52,000
Total	$568,000 *

FN* The parties made a computational error in their stipulation. This amount was reported as $516,000 in the stipulation, not $568,000.

FN3. According to the parties, net asset value is generally the difference between assets and liabilities, where assets have been adjusted to reflect fair market values and liabilities have been adjusted to reflect the reality of their ultimate payment.

FN4. The Cardenas reports are admissible on other grounds as well. One significant distinction between expert and fact witnesses is that experts are permitted to rely on evidence outside the trial record. See *H Group Holding, Inc. v. Commissioner*, T.C. Memo.1999-334. The evidence outside the record may be hearsay and need not be otherwise admissible, but it can be used by the expert to formulate an opinion. See Fed.R.Evid. 703.

FN5. With respect to the cost approach, the estate's expert said the following:
The Cost Approach to value is an indicator for new or proposed improvements, however, older improvements, such as the subject are more difficult to analyze. The most important factor in appraising older properties is the estimate of depreciation. Although great care is taken in this analysis, it is difficult for the Appraiser to truly and accurately estimate the value losses by depreciation. This is mainly due to the lack of full knowledge of the infrastructure of a building. You cannot see into the walls and many areas are inaccessible. Therefore, it is difficult to determine the true condition of all building components. This weakens the support for the depreciation estimate. The typical purchaser does not generally use this approach to make an investment decision. * * * Also, there is a lack of * * * [comparable] land sales. This makes the analysis for the land value weak. Therefore, this approach is given least weight in support of the final estimate of value.
As for the sales comparison approach, we are concerned about the lack of suitable comparables in the Monecito-Santa Barbara area upon which to base any meaningful analysis. Mr. Holden echoed this concern in his report, stating that "Due to the varying characteristics of the sales data, direct market comparison [as a method to value MVN and MVS] is weak." Under the circumstances of the instant case, the sales comparison approach is unreliable. This unreliability is reflected in Mr. Holden's report where he abandons his cost approach and sales comparison analyses and adopts whole hog his conclusions from his discounted cash-flow analysis as the fair market value of MVN and MVS.

FN6. The cash-flow estimates of the experts are as follows:

	MVN Holden	Marx
Year 1	$849,228	$812,778
Year 2	866,213	845,042
Year 3	883,537	876,840

Year 4	901,208	887,042
Year 5	946,268	923,371
Year 6	993,582	941,771
Year 7	1,043,261	948,896
Year 8	1,095,424	1,007,989
Year 9	-	1,156,425
Year 10	-	1,171,932
Year 11	-	1,209,313

	MVS Holden	Marx
Year 1	$560,638	$598,160
Year 2	547,080	472,941
Year 3	561,617	592,840
Year 4	584,522	613,129
Year 5	610,669	628,580
Year 6	634,919	644,039
Year 7	652,406	627,970
Year 8	685,026	652,898
Year 9	-	686,984
Year 10	-	693,587
Year 11	-	707,083

FN7. The discount rate is a rate of return on capital used to convert future payments, rental income, or receipts into a present value.

FN8. In 1991, the average capitalization rate in southern California was 9.06 percent; in 1992 it was 9.59 percent; in 1993 it was 9.70 percent; in 1994 it was 10.66 percent; and in 1995 it was 10.26 percent.

FN9. We arrived at this amount as follows:

Net asset value			$15,924,290
Total assets at market value		$18,467,290	
Less book value		(5,649,963)	
Unrealized capital gain		$12,817,327	
Net California gain	$12,817,327		
Less: California tax at 9.3%	(1,192,011)		
Net Federal gain	$11,625,316		
Less: Federal tax at 34%	(3,952,607)		
Total Tax		$5,144,618	

on capital gain	
TOTAL CAPITAL GAIN AS A PERCENTAGE OF NET ASSET VALUE:	32.3%

FN10. The current fair market value of the built-in gain assets is $17,704,290 ($17,361,110 (real estate) plus (investments in stock and art) $343,180). Such amount, assuming a 2-percent annual growth rate for the 10-year holding period, would be worth $21,581,354 on Jan. 12, 2004. After adjusting for annual depreciation of $156,000 per year during the 10-year holding period (adding $1,560,000 to the projected built in gain), the total projected built-in gain on Jan. 12, 2004, is $18,052,828. The California tax on that amount, at 9.3 percent is $1,678,913. Total Federal gain is $16,373,915 and, taxed at the 34-percent corporate Federal rate, produces $5,567,131 in Federal tax. The total amount of Federal and California taxes on the projected built-in gain is $7,246,044. Assuming, as Mr. Wilde did, a discount rate of 8.3 percent (Long term AFR + 2 percent for added risk), the present value of the future $7,246,044 in taxes is $3,264,571. This amount, as a percentage of net asset value, is 20.5 percent ($3,264,571 divided by $15,924,290).

U.S.Tax Ct.,2000.
Borgatello v. C.I.R.
T.C. Memo. 2000-264, 2000 WL 1172345 (U.S.Tax Ct.), 80 T.C.M. (CCH) 260, T.C.M. (RIA) 2000-264, 2000 RIA TC Memo 2000-264

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